SUPREME COURT, U. S.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

No. 51

IN THE MATTER OF:
AMERICAN SOUTHERN PUBLISHING COMPANY,
Bankrupt,
GEORGE LEWIS BAILES, JR., the Trustee,
Petitioner,

versus,

THE FIRST NATIONAL BANK OF MOBILE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit

R. CLIFFORD FULFORD
433 Frank Nelson Building
Birmingham, Alabama 35203
Counsel for Petitioner

Of Counsel
MAX C. POPE
LEVINE, FULFORD & POPE
433 Frank Nelson Building
Birmingham, Alabama 35203

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PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit

To the Honorables, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit dated April 20, 1970, on which petition for rehearing and for rehearing en banc was denied on May 25, 1970.

OPINIONS BELOW

The Orders of the Referee in Bankruptcy (Appendix A-1 and 2); the Order of the District Court denying review (Appendix B); the Opinion and Judgment of the United States Court of Appeals for the Fifth Circuit (Appendix C-1 and 2), and its denial of the petition of the Trustee in Bankruptcy for rehearing and for rehearing en banc (Appendix C-3). The Fifth Circuit's Opinion is reported at 426 F. 2d 160.

JURISDICTION

The opinion and judgment of the United States Court of Appeals for the Fifth Circuit was entered on April 20, 1970 (Appendix C-1 and 2). That Court denied petition for rehearing and for rehearing en banc on May 25, 1970 (Appendix C-3).

Jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED

Circumstances of the Case

This case is here on undisputed facts in this context:

Textbooks of a bankrupt publisher were, at the time of bankruptcy, in the actual possession of one who had received them under contract to hold them as the bankrupt-publisher's "trustee" and to be its "agent" in shipping them when sold by the bankrupt publisher to state schools and others. **The agent asserted no adverse interest in itself.** A creditor who admittedly had no recorded security or warehouse receipt claimed only that correspondence between itself, the bankrupt-publisher and the agent, several weeks before bankruptcy, had the effect of making the bankrupt-publisher's agent the creditor's agent (the agent having agreed, to the extent it legally could, not to ship the books without the creditor's consent). The creditor contended that this created a common law pledge and, on that basis alone, objected to the bankruptcy court's jurisdiction to resolve the controversy which developed on bankruptcy between the trustee and the creditor in relation to the books.

The Referee and the District Court agreed that jurisdiction did exist (Appendices A and B), but the Fifth Circuit reversed ostensibly without prejudice to plenary disposition. 426 F. 2d 160 (Appendix C). Its reasoning was that the bankruptcy court lacked jurisdiction because the agent's possession was not *unconditionally* for the bankrupt. However, the court did not expressly find that the agent's possession *was for* the creditor claiming a pledge.

The Questions

1. Is it possible for the Fifth Circuit's decision to be "without prejudice"? **Possession** being determinative of both the jurisdictional issue and the substantive issue, and the Fifth Circuit having decided that the bankruptcy court did not have jurisdiction because the bankrupt did not have **possession** at the time of bankruptcy, can a court decide on plenary consideration that the creditor did not then have the **possession** required to support the pledge it asserts in opposition to bankruptcy jurisdiction and in support of its claim?

2. Does *res judicata's* foreclosure of the trustee on plenary consideration of his controversy with the creditor over the books deny the trustee due process under the Fifth Amendment?

3. Does a bankruptcy court have jurisdiction to determine controversies relating to a bankrupt's property **in the possession of one who asserts no adverse interest therein**, where an adverse claim is asserted by a creditor?

4. Can a bankruptcy court's jurisdiction to adjudicate controversies over a bankrupt's personal property be defeated by a creditor claiming only a pledge, without a finding that the creditor had such open, exclusive and unequivocal possession as to put other creditors (represented by the trustee) on notice that the bankrupt's property was subject to the creditor's claimed security interest, there being no actual or recorded notice to other creditors?

5. Is the Fifth Circuit's decision in conflict with the purpose and intent of Congress, expressed in the Bankruptcy Act, that the administration of bankruptcy be expeditious, efficient and inexpensive to the end of equality of distribution to creditors?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the constitutional provisions and statutes cited below and reproduced verbatim, in the parts here pertinent, in Appendix D.

The Due Process Clause of the Fifth Amendment to the Constitution of the United States.

28 U. S. C., § 1334, giving the district courts "original jurisdiction exclusive of the courts of the States, of all matters and proceedings in bankruptcy."

The Bankruptcy Act: § 2a(7) and (15), 11 U. S. C., § 11(a)(7) and (15); § 23a and b, 11 U. S. C., § 46(a) and (b); § 70a(5), 11 U. S. C., § 110(a)(5); and § 70c, 11 U. S. C., § 110(c).

Alabama statute relating to State's purchase of textbooks for use in its public schools, **Alabama Code** 1940 (Recomp. 1958), Title 52, §§ 433(30), (31) and (33).

STATEMENT OF THE CASE

Bankrupt was a publisher under contract and performance bond with the State of Alabama to sell and deliver certain textbooks to its public schools. At the time of bankruptcy the textbooks in question, constituting about 70% of the bankrupt's estate, were in the actual possession of Ebsco Investment Services, Inc. (Publishers' Warehouse Division), hereinafter called "Agent", a specialized independent corporation in Birmingham under contract with the publisher to hold its books as its "trustee", to act as its "agent" in storing and shipping them to public schools on order of the State, and to sell and deliver them to others. Bankrupt's books were commingled with the books of about fifty other publishers served in a like manner by the Agent. **The agent made no adverse claim to the books.**

The First National Bank of Mobile (hereinafter "Bank"), admitting that it had no recorded security instrument or warehouse receipt, claimed a common law pledge on the textbooks arising a few weeks before bankruptcy out of correspondence between and known only to the Bank, the Bankrupt, the Agent, and officials of the State of Alabama in charge of ordering and paying for the textbooks. According to this exchange of letters, Bankrupt was to continue to sell and the Agent to ship the books as before except that the Agent agreed, to the extent it could legally do so, not to ship books to Alabama schools without the Bank's consent. Consent of the Bank was not required for the Agent to sell and ship books sold to others than the State of Alabama. Payments on accounts receivable due to the publisher from the State of Alabama, and the net proceeds of sales by the Agent to others than the State, were to be sent to the Bank for deposit in an escrow account in the bankrupt-publisher's

name. The Bank was named as mortgagee loss payee of the publisher's fire insurance policy on the books in Agent's actual possession, although no mortgage or other security instrument was ever executed or recorded. On one occasion about two weeks before bankruptcy, the Agent obtained the Bank's consent to release complimentary copies of textbooks sent by the publisher to teachers.

From August 22 to September 30, 1966, the bankrupt-publisher signed ten promissory collateral form notes to the Bank, each stating that the books, described in an attached and referenced photocopy of an inventory prepared months earlier by the Agent, had been deposited and pledged as collateral security. This inventory did not meet the requirements for and did not purport to be a warehouse receipt.

On October 7, 1966 (seven days after the last note was signed), Bankrupt filed its petition under the Bankruptcy Act, and the Trustee asserted his dominion over the books, insisting that the Agent's actual possession was constructively that of the Bankrupt, and demanded that proceeds from all sales *after the date of bankruptcy* be paid to him. Only two shipments of books to State schools resulting in deposits in the escrow account had been made before bankruptcy intervened, and the Bank's consent had been obtained to one but not the other of these shipments made by Agent.

The Bank had not assumed and obviously could not perform the bankrupt-publisher's bonded contractual obligations to supply textbooks to the State. Claiming only a pledge, neither could the Bank pass title to the books. Further, under an Alabama statute enacted in 1965 which abolished and prohibited mandatory State textbook depositories, the State was required to issue its purchase

orders for textbooks directly to the publisher who alone could invoice the State for these sales. **Alabama Code** 1940 (Recomp. 1958), title 52, § 433(30), (31) and (33), reproduced in Appendix D. Thus, only the publisher (and not the Bank or the Agent) could deal with the State in consummating these sales. Upon bankruptcy, the Trustee succeeded to the bankrupt publisher's rights and obligations under the textbook contracts with the State and was the only one who could continue to sell and invoice for textbooks purchased on the State's orders to the Trustee.

To avoid a breach of the bankrupt publisher's bonded contract to supply the textbooks to the State and the resulting liability such a breach would have involved, the Trustee agreed with the Bank and the Agent (with the Referee's approval) to continue and did continue to fill and invoice orders from the State, with the stipulation that the proceeds of these and other sales would be escrowed in the Bank without prejudice and subject to the parties' rights to the books themselves at the time of bankruptcy. When the sales proceeds reached the amount of the Bank's claim, the Trustee petitioned and invoked the jurisdiction of the bankruptcy court [see § 2a(7) of the Bankruptcy Act, 11 U. S. C., § 11(a)(7); and 28 U. S. C., § 1334, reproduced in Appendix D] to determine the controversy between the Trustee and the Bank in relation to the books, and to decide and decree that the Trustee, and not the Bank, had constructive possession of the books at and from the time of bankruptcy and was consequently entitled to the sales proceeds. The Bank objected to the Referee's jurisdiction, and this objection was first separately heard and overruled (Appendix A-1). At the subsequent hearing on the merits, the Bank submitted on the same testimony, and the Referee decreed that the actual possession of the Agent was constructively

for the Bankrupt, and that the Trustee was therefore entitled to the books and their sales proceeds (Appendix A-2). The District Court confirmed the Referee on review (Appendix B). The Fifth Circuit reversed and ordered the Trustee's petition dismissed for lack of jurisdiction in the bankruptcy court ostensibly without prejudice to resolution of the controversy in a plenary proceeding. 426 F. 2d 160 (Appendix C).

REASONS FOR GRANTING THE WRIT

I

Is It Possible for the Fifth Circuit's Decision to Be "Without Prejudice"? POSSESSION Being Determinative of Both the Jurisdictional Issue and the Substantive Issue, and the Fifth Circuit Having Decided That the Bankruptcy Court Did Not Have Jurisdiction Because the Bankrupt Did Not Have POSSESSION at the Time of Bankruptcy, Can a Court Decide on Plenary Consideration That the Bank Did Not Then Have the POSSESSION Required to Support the Pledge It Asserts in Opposition to Bankruptcy Jurisdiction and in Support of Its Claim?

The Fifth Circuit's reasoning here comes full circle upon itself.

The Supreme Court has held that the determination of the issue of a bankruptcy court's jurisdiction is res judicata and cannot be attacked by a party to that determination. **Stoll v. Gottlieb**, 305 U. S. 165 (1938); **Chicot Co. Drainage Dist. v. Baxter State Bank**, 308 U. S. 371 (1940); and cf. **Katchen v. Landy**, 382 U. S. 323 (1966).

"Possession" is central to the issue of jurisdiction as well as to the issue of pledge the Bank claims it had. Unless "possession" can exist in a vacuum, it is not possible to decide the issue of jurisdiction, in all its implications, without also deciding the issue of pledge. Is "possession" one thing for a bankruptcy court's jurisdiction and something else for a pledge?

On what basis could a court exercising plenary jurisdiction decide that the Bankrupt did, after all, have "possession" at the time of bankruptcy? (The facts are undisputed.) On what basis might a plenary court decide that the Bank did not have "possession" at the time of

bankruptcy? (The facts are undisputed.) Assuming that a basis exists for either finding, the plenary court reaching such a conclusion would necessarily decide against its own jurisdiction; because if the Bankrupt had constructive possession at the time of bankruptcy, or if the Bank did not then have constructive possession, the bankruptcy court would then have exclusive, non-delegable jurisdiction that could not be surrendered.[1] Would the plenary court then withdraw in favor of the bankruptcy court? Even if it did, the Trustee could not pursue the matter in the bankruptcy court. The Fifth Circuit has held that the bankruptcy court does not have jurisdiction.

It is paradoxical that if the Bank should now confess in a plenary suit that it had no pledge, it would thereby destroy the plenary court's jurisdiction and the Trustee's right to a final adjudication of his entitlement to the books. In such a case, res judicata or collateral estoppel[2] would obviously prevent the Bank from contending that the plenary court did not have jurisdiction because the bankruptcy court did.[3] If res judicata and collateral estoppel operate against the Bank in such a case, would those principles not also apply to the Trustee to whom this

[1] Thompson v. Magnolia Petroleum Co., 309 U. S. 478 (1940); Harris v. Avery Brundage Co., 305 U. S. 160 (1938); Taylor v. Sternberg, 293 U. S. 470 (1935); Ex Parte Baldwin, 291 U. S. 610 (1934); Gross v. Irving Trust Co., 289 U. S. 342 (1933); Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734 (1931); May v. Henderson, 268 U. S. 111 (1925); Taubel-Scott-Kitzmiller Co. v. Fox, 264 U. S. 426 (1924); Lazarus v. Prentice, 238 U. S. 263 (1914); Hebert v. Crawford, 228 U. S. 204 (1913); United States Fidelity & G. Co. v. Bray, 225 U. S. 205 (1912); Murphy v. John Hofman Co., 211 U. S. 562 (1909); Whitney v. Wenman, 198 U. S. 539 (1905); Mueller v. Nugent, 184 U. S. 1 (1902); and White v. Schloerb, 178 U. S. 542 (1900).

[2] See Ashe v. Swenson, 397 U. S. 436, 443 (1970).

[3] Stoll v. Gottlieb, 305 U. S. 165 (1938); and cf. Treinies v. Sunshine Mining Co., 308 U. S. 66 (1939); Davis v. Davis, 305 U. S. 32 (1938); American Surety Co. v. Baldwin, 287 U. S. 156 (1932); and Baldwin v. Iowa State Traveling Men's Asso., 283 U. S. 522 (1931).

becomes a case of "heads-you-win, tails-I-lose"? Cf. **Hebert v. Crawford**, 228 U. S. 204, 208 (1913).

Has the Fifth Circuit unintentionally foreclosed the meaningful plenary consideration of the Trustee's controversy with the Bank over the books? If a plenary court should decide that the Bank had not sustained its asserted pledge as good against the Bankrupt's creditors and the Trustee, could that judgment be permitted to stand?

We urge the Supreme Court to grant certiorari to consider and resolve this novel jurisdictional enigma.

II

The Fifth Circuit's Decision Constitutes a Denial of Due Process to the Trustee.

The Fifth Circuit obviously did not consider the substantive issue, or even the jurisdictional issue in the light of its relationship to the substantive issue. It plainly thought that the substantive rights could be reserved for plenary consideration and disposition where the Trustee's and the Bank's respective claims to the books could be considered "without prejudice."

This premise being faulty, it would follow that the Trustee is being denied due process guaranteed by the Fifth Amendment; for if the Fifth Circuit's decision on the issue of "possession" forecloses plenary consideration of "possession" on the substantive issue, the Trustee is denied the opportunity to have his substantive right to the books considered in **any** forum.[4]

There is a degree of anticipation in this denial of constitutional right which would not occur until the plenary

[4] Due process has been said to require "an opportunity for hearing appropriate to the nature of the case." **Mullane v. Central Hanover Trust Co.**, 339 U. S. 306, 313 (1952). See also and cf. **American Surety Co. v. Baldwin**, *supra*, note 3.

court actually applies res judicata or collateral estoppel to foreclose the Trustee. However, there is a strong analogy in **Katchen v. Landy**, *supra*. Anticipating that the bankruptcy court's adjudication of a trustee's § 57g objection to a claim on the basis of preference would be res judicata to any plenary consideration of the issue of preference, it was held that the bankruptcy court had jurisdiction to order surrender of the preference. The Supreme Court there said "That to require the trustee to commence a plenary action in such circumstances would be a meaningless gesture. . . ." (382 U. S. at 335).

It would indeed be a meaningless gesture for the Trustee to assert further an insistence on which the Fifth Circuit's decision as to "possession" has foreclosed him.

Unless the writ here prayed is granted, this case is over, and the Bank will prevail without ever having been adjudicated in possession of the books.

The denial to the Trustee of all opportunity to be heard on the merits of his right to the books constitutes a present denial of due process.

III

The Fifth Circuit's Decision Is in Conflict With Other Circuits on the Issue Whether the Bankruptcy Court Has Jurisdiction Over a Bankrupt's Property Held by One Not Adverse to the Bankrupt and Claimed by Another. This Question Has Not Been, But Should Be, Settled by the Supreme Court.

The Bank's objection to the bankruptcy court's jurisdiction was based solely on the pledge it claimed. Yet the Fifth Circuit failed to find from undisputed facts that the Bank had even constructive possession.

If the Bank did not have at least constructive possession, it had no pledge.[4] If there was no pledge, the Bank had no substantial claim to the Bankrupt's books good against the Trustee,[5] and its objection to the jurisdiction of the bankruptcy court would necessarily fail.

The Supreme Court has several times said that the bankruptcy court's jurisdiction extends to controversies relating to a bankrupt's property in the possession of a person who makes no claim to it.[6] Those statements were made in cases not involving pledge but would be dispositive except for the presence here of an element there absent: a claim by one not in possession against the bankrupt's property actually held by one not adverse.

Other circuits have confronted this element and held, contrary to the Fifth Circuit, that the bankruptcy court does have jurisdiction.

The Second Circuit has sustained a bankruptcy court's jurisdiction over the proceeds of sale of a bankrupt's Stock Exchange seat, in the possession of the Exchange, over the objection of one claiming adversely under a sale of the seat made by the bankrupt some days before bankruptcy. In that case, **In re Hoey**, 290 F. 116 (1923), the court said:

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[4] **Casey v. Cavaroc**, 96 U. S. 467 (1878); **Security Warehousing Co. v. Hand**, 206 U. S. 415 (1907); **In re Harvey**, 212 F. 340 (D. C., S. D. Ala., 1914); **Lauderdale County Co-op v. Lansdell**, 260 Ala. 452, 71 So. 2d 70 (1954).

[5] **Whitney v. Wenman**, *supra* note 1; **Security Warehousing Co. v. Hand**, *supra* note 5.

[6] **Harris v. Avery Brundage Co.**, *supra* note 1; **May v. Henderson**, *supra* note 1; **Taubel-Scott-Kitzmiller Co. v. Fox**, *supra* note 1; **Lazarus v. Prentice**, *supra* note 1; and **Babbitt v. Dutcher**, 216 U. S. 102, 113 (1910). See also and cf. **Thompson v. Magnolia Petroleum Co.**, *supra* note 1, where it was noted that no one had possession of the fugitive oil apart from the lands under which it lay (309 U. S. at 182); **Board of Trade v. Johnson**, 264 U. S. 1 (1924); **Hebert v. Crawford**, *supra* note 1; and **Mueller v. Nugent**, *supra* note 1.

". . . The objection that the District Court had no jurisdiction to entertain summary proceedings . . . cannot be sustained. . . . It is only where right to property, adverse to a defendant and his creditors, is asserted by a party in possession, that a separate suit in which such right can be adjudicated is necessary" (290 F. at 120).

The Second Circuit has also ruled that a bankruptcy court has jurisdiction over a sewer-assessment refund filed by New York City where the trustee of the bankrupt-purchaser, and the seller, of the assessed real estate both claimed it. **Lahey v. Trachman**, 130 F. 2d 748 (1942).

The Sixth Circuit has held that a bankruptcy court had **exclusive** jurisdiction to determine a creditor's claim to a fund paid by Venezuela into the United States Treasury upon its annulment of a mining lease in the name of a bankrupt at the time of bankruptcy, where the United States made no adverse claim. **Orinoco Iron Co. v. Metzel**, 230 F. 40 (1916).

The Ninth Circuit has held in a corporate reorganization proceeding that the bankruptcy court has jurisdiction to determine the validity of an adverse claimant's asserted lien on a property interest in the possession of one not claiming adversely to the reorganization debtor, **Baker & Taylor Drilling Co. v. Stafford**, 369 F. 2d 551 (1966); and that a bankruptcy court has summary jurisdiction to order a sheriff to surrender property obtained by levy on a judgment obtained within four months of bankruptcy, notwithstanding the pendency of a replevin action against the sheriff by another claiming ownership, **In re Francis-Valentine Co.**, 94 F. 793 (1899).

See also **O'Dell v. Boyden**, 150 F. 731 (CCA 6, 1906); and Judge Learned Hand's opinion in **In re Hoey, Tilden & Co.**, 292 F. 269 (D. C. S. D. N. Y., 1923), resolving this issue in favor of the bankruptcy court's jurisdiction and saying, "I must own that the question is by no means free from doubt and it is to be hoped that it may be authoritatively settled" (292 F. at 272).

See also the dictum of the Eighth Circuit in **Shea v. Lewis**, 206 F. 877 (1913), as follows:

> ". . . When those in possession are not adverse claimants, but are only representatives of the bankrupt, without claim or lien upon, or right to, the property in themselves, the bankruptcy court may by summary proceeding take the actual possession of the property, and then, when it has thus acquired actual possession, may by summary proceedings determine the validity of claims or liens upon and titles to it . . ." (206 F. at 880-881).

It is patently impossible to decide the jurisdictional question in this case, depending as it does upon possession, without examining the substantive rights of the parties to the property in controversy, also dependent upon the issue of possession necessary to support the asserted pledge as good against the Trustee. The Fifth Circuit's failure to consider and decide the substantive issue where necessary to determine the jurisdictional question is contrary to the Supreme Court's approach in two parallel cases, one of which is highly similar to this case. In **Whitney v. Wenman**, 198 U. S. 539 (1905), the Supreme Court examined the merits of the controversy to determine that the bankruptcy court did have jurisdiction, by virtue of § 2 of the Bankruptcy Act, over the bankrupt's goods supposedly pledged to a warehouse company which issued receipts delivered to creditors making advances, where the goods remained in control of the bankrupt who continued to sell them, even though the bankruptcy receivers had surrendered possession to the warehousing company. In **Thompson v. Magnolia Petroleum Co.**, 309 U. S. 478 (1940), the Supreme Court held that the bankruptcy court had jurisdiction to adjudicate the title to lands where necessary to resolve the controversy between the trustee and adverse claimants over fugitive oil in the possession of no one apart from a reorganization railroad's right of way under which it lay.

The Fifth Circuit's finding here that the Agent's actual possession was not constructively for the Bankrupt, without more, is manifestly inadequate as a basis for denying the bankruptcy court's jurisdiction. The additional finding (here missing) that the Agent's possession was constructively for the Bank is indispensable to the conclusion that the bankruptcy court lacked jurisdiction. As to the jurisdiction of the bankruptcy court, the Agent held the books either for the Bankrupt or for the Bank; and if the Agent's possession was not for the Bank, it was for the Bankrupt, and in that event the bankruptcy court had jurisdiction to determine all controversies with respect to the books, including the character and extent of the Bank's claim.

Denying jurisdiction to a court of bankruptcy in a case such as this would have some very ineffectual and lawless consequences. If the Trustee and the Bank had both come with trucks to take actual possession of the books from the Agent at the time of bankruptcy, in what court could their controversy have been determined? In what court could the Agent have impleaded the books? See, e. g., **Emery & Kaufman, Ltd. v. Houston Fire & Casualty Ins. Co.**, 115 So. 2d 213 (La. Ct. App. 1959).

Isn't this the very kind of case Congress must have had in mind when, by § 2a(7) of the Bankruptcy Act, it gave jurisdiction to courts of bankruptcy to "Cause the estates of bankrupts to be collected, reduced to money, and distributed, and **determine controversies in relation thereto.** . . ."? [U. S. C., § 11(a)(7); emphasis supplied.]

By granting the writ prayed, the conflict between the circuits can be resolved.

IV

As Against Bankrupt's Other Creditors and the Trustee, the Bank's Claim Is Insubstantial, and the Bankruptcy Court Has Jurisdiction Even if Possession Was Not in the Bankrupt at the Time of Bankruptcy. In This Aspect, the Fifth Circuit's Decision Is in Conflict With Applicable Decisions of the Supreme Court and With Decisions of Other Circuits.

If the adverse claim is insubstantial, the bankruptcy court has jurisdiction even if possession was not in the bankrupt at the time of bankruptcy.[9]

There was available to the Bank, under Alabama law, at least four ways to take and record a security interest.[10] The Bank might also have required delivery to it of a valid warehouse receipt[11] or it could have entered into a bona fide "field warehousing arrangement."[12] The Bank did none of these. There is a temptation to think that the pledge the Bank claimed was the afterthought of resourceful counsel charged with the task of rescuing a client from its oversight.

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[9] **Sampsell v. Imperial Paper & C. Corp.**, 313 U. S. 215 (1941); **Taylor v. Sternberg**, *supra* note 1; **May v. Henderson**, *supra* note 1; **Lazarus v. Prentice**, *supra* note 1; **Whitney v. Wenman**, *supra* note 1; **Mueller v. Nugent**, *supra* note 1; **Bryan v. Bernheimer**, 181 U. S. 188 (1901); **White v. Schloerb**, *supra* note 1. Cf. **Williams v. Austrian**, 331 U. S. 642, 652 (1947). 2 **Collier on Bankruptcy**, 14th Ed., ¶ 23.06 at n. 7, p. 496; and ¶ 23.05 at n. 7, pp. 468-469.

[10] See **Alabama Code** 1940 (Recomp. 1958): Title 47, § 110 (chattel mortgages); Title 40, § 123 (conveyances of personal property to secure debts); Title 47, § 95 (other documents of security); Title 47, § 132(1)-(8), inclusive (factors); and Title 39, §§ 207-214, inclusive (assignment of accounts receivable).

[11] **Alabama Code** 1940 (Recomp. 1958), Title 2, §§ 504, et seq. (Uniform Warehouse Receipt Act).

[12] See, e. g., **Ribaudo v. Citizens National Bank of Orlando**, 261 F. 2d 929 (CA 5, 1958). See also 4A **Collier on Bankruptcy**, 14th Ed., ¶ 70.56[2].

The question here is not whether the arrangement was valid as between the publisher and the Bank, but whether it was good as against the Bankrupt's other creditors who had no notice of the Bank's claim of security. To be good against other creditors and against the Trustee who represents them, the pledge asserted by the Bank would have had to be supported by complete, unequivocal and exclusive possession in the Bank as pledgee—such possession as to signify "to the world what property was and what property was not pledged."[13] The books were certainly not actually "deposited and pledged as collateral security" with the Bank just because its collateral form notes said so; and in the entire scheme, the word "pledge" appeared nowhere else—not even in the correspondence.

Title does not pass from the pledgor in a valid pledge; only possession passes. **Minge v. Clark**, 193 Ala. 447, 69 So. 421 (1915). As to other creditors possession is permitted as a substitute for recording because the pledgee's possession and the absence of possession in the pledgor, make it impossible for other creditors to be mislead.[14]

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[13] **Swetnam v. Edmund Wright Ginsberg Corporation**, 128 F. 2d 1, 4 (CCA—2, 1942); **Casey v. Cavaroc**, *supra* note 5; **Whitney v. Wenman**, *supra* note 1; **Security Warehousing Co. v. Hand**, *supra* note 5. See especially **Lewis v. Bank of Mobile**, 204 Ala. 689, 87 So. 176 (1920), holding a pledge "wholly void as to creditors" under the Alabama statute of frauds [now **Alabama Code** 1940 (Recomp. 1958), Title 20, § 1] where the pledgor retained possession. Cf. **Samson Tire & Rubber Co. v. Eggleston**, 45 F. 2d 502 (CCA—5, 1930).

[14] Cases cited note 13 *supra*; and cf. **Benedict v. Ratner**, 268 U. S. 353 (1925), holding a secret assignment of accounts receivable void as to creditors, where the Supreme Court said that ". . . whether the collateral consist of chattels or of accounts, reservation of dominion inconsistent with the effective disposition of title must render the transaction void. . . . That doctrine [of ostensible ownership] raises a presumption of fraud where chattels are mortgaged (or sold) and possession of the property is not delivered to the mortgagee (or vendee). **The presumption may be avoided by recording** the mortgage (or sale)" (268 U. S. at 361-362; emphasis supplied).

". . . [T]he rule of possession does not rest on actual deception, but on the possibility of it." **Swetnam v. Edmund Wright Ginsberg Corporation**, 128 F. 2d 1, 4 (CCA—2, 1942). That element—possession in the pledgee sufficient to make a pledge valid against other creditors represented by the Trustee—is what the undisputed facts show is missing here. Consideration of this element has been wholly pretermitted by the Fifth Circuit.

§ 70a(5) of the Bankruptcy Act vests the trustee, as of the time of bankruptcy, with title to all property the bankrupt could have transferred, or which could have been levied upon and sold under judicial process against him, or otherwise seized, impounded or sequestered. These books were undisputedly in that category.[15] And § 70c, the so-called "strong-arm clause" of the Bankruptcy Act, arms the trustee, as of the date of bankruptcy, with the status of the ideal creditor which, in Alabama, puts the trustee ahead of unrecorded security interests.[16] Only if an unrecorded creditor had such "open, exclusive and unequivocal possession" as to inform all the bankrupt's other creditors and keep them from being deceived, would that creditor not be cut off by a trustee's rights which attach when a petition is filed under the Bankruptcy Act.[17]

On this premise the Bank's claim is clearly insubstantial. Even if, as between the publisher and the Bank, the

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[15] **Knapp v. Milwaukee Trust Co.**, 216 U. S. 545 (1910); **Security Warehousing Co. v. Hand**, *supra* note 5; **Mueller v. Nugent**, *supra* note 1. Cf. **Casey v. Cavaroc**, *supra* note 5.

[16] **McKay v. Trusco Finance Co. of Montgomery, Alabama**, 198 F. 2d 431 (CA—5, 1952); and **Samson Tire & Rubber Co. v. Eggleston**, *supra* note 13.

[17] See **In re Harvey**, *supra* note 5, and **In re Automobile Livery Service Co.**, 176 F. 792 (DC, ND-Ala., 1910), to the effect that subsequent delivery to the pledgee is not good in Alabama against intervening rights. Cf. **Corn Exchange Nat. Bank & T. Co. v. Klauder**, 318 U. S. 434 (1943), and **Benedict v. Ratner**, *supra* note 14. And see the oft-quoted ". . . the filing of the petition is a *caveat* to all the world, and in effect an attachment and an injunction . . ." in **Mueller v. Nugent**, *supra* note 1.

Agent's possession was constructively for the Bank, and whatever its validity as between the parties, it was patently not good as against other creditors without notice represented from and after bankruptcy by the Trustee; and where the adverse claim is insubstantial, the bankruptcy court has jurisdiction even if the bankrupt did not have possession.

If allowed to stand, the Fifth Circuit's decision will shake the purpose and foundation of recording statutes. Recording and the notice it provides will no longer be adequate if pledges can be created by correspondence between the parties, as here, purporting to change an agent's possession for one to possession for another without any change in the physical possession of the property itself.

If a subsequent lender had made a loan on a recorded security of the books, or if the United States had recorded a tax lien, would the Bank's asserted pledge be recognized as superior to the subsequent lender's recorded security instrument and the Government's recorded tax lien? Unless it would, the Bank's claim must certainly be so insubstantial that it could not prevail over the Trustee; and in that event, the bankruptcy court's jurisdiction would attach.

In this aspect the Fifth Circuit's decision is contrary to the Supreme Court's decisions in the highly similar cases of **Security Warehousing Co. v. Hand**, 206 U. S. 415 (1907), and **Whitney v. Wenman**, *supra*, in which pledges asserted by creditors were struck down as insufficient in controversies with trustees in bankruptcy. In **Whitney v. Wenman** the bankruptcy court's jurisdiction was sustained, over objection, to determine the rights of parties claiming interests in the property. See also **Casey v. Cavaroc**, 96 U. S. 467 (1878); a highly similar case decided under the National Banking Act of 1864. The Fifth Circuit's decision is another instance of judicial sanction

of secret transfers and non-notification financing which the Supreme Court found contrary to Congressional intent under the Bankruptcy Act in cases such as **Corn Exchange Nat. Bank & T. Co. v. Klauder**, 318 U. S. 434 (1943), and **Benedict v. Ratner**, 268 U. S. 353 (1925).

The Fifth Circuit's decision is also in conflict with the Second Circuit's decision in the very similar case of **Swetnam v. Edmund Wright Ginsberg Corporation**, *supra*; and with the Fourth Circuit's decision in **Lindsey-Robinson & Company v. Grady**, 282 F. 2d 607 (1960), where it was held that the adverse claimant of flocks of chickens in the actual possession of a former agent of the bankrupt holding for the claimant at the time of bankruptcy did not entitle him to prevail against the trustee where the claimant did not record. Characterizing the adverse claim as colorable only, the Fourth Circuit held that the bankruptcy court obtained constructive possession of the flocks when the petition in bankruptcy was filed and was "therefore empowered to adjudicate ownership of the flocks in the exercise of summary jurisdiction." 282 F. 2d at 614.

These conflicts should be resolved in the interest of uniformity under the Bankruptcy Act.

V

The Fifth Circuit's Decision Thwarts the Policy of Congress, Expressed in the Bankruptcy Act, Favoring Efficient and Inexpensive Administration of Bankruptcy Cases.

The Supreme Court has often noted that the policy of Congress, expressed in the Bankruptcy Act, favors the efficient, expeditious and inexpensive administration of bankruptcy cases. See, e. g., **Katchen v. Landy**, *supra* at 328-329; and **United States Fidelity & G. Co. v. Bray**, 225 U. S. 205 (1912).

The Fifth Circuit's decision casts increased doubt and confusion about a bankruptcy court's jurisdiction and dims the outlook for efficient inexpensive administration under the Bankruptcy Act. Courts of bankruptcy daily confront the dilemma of exercising a jurisdiction they cannot surrender or delegate if they have jurisdiction; and they cannot be sure they have it. Trustees in bankruptcy are forced to thrust and probe in the bankruptcy court for a jurisdiction which is exclusive of all others if it is there; and if it is not, they must start over in a plenary proceeding if they are not then barred by a statute of limitations or laches. This thrust and probe is made unavoidable not because of any rule of jurisdiction in the usual sense, but to satisfy (when it applies) an adverse party's personal privilege, which he can assert or withhold as he chooses.[18]

Decisions such as the Fifth Circuit's in this case irresistibly suggest that the Congressional purpose for efficient, expeditious and inexpensive bankruptcy administration would be better served if all adverse claims had to be tried plenarily. That would at least eliminate the thrusting and probing which makes a shambles of efficiency and economy when a bankruptcy court's jurisdiction is finally not found where it was thought to exist;[19] because until then, the trustee cannot proceed elsewhere. (In this case he cannot proceed anywhere.)

It is obviously not the policy of Congress that all adverse claims be tried plenarily. In enacting § 2a of the

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[18] **McDonald v. Plymouth County Trust Co.**, 286 U. S. 263 (1932); **Page v. Arkansas Natural Gas Corp.**, 286 U. S. 269 (1932).

[19] See Cowans, *An Agenda for Bankruptcy Reformers*, 43 **Ref. J.** 47 (April 1969); at page 48 under heading "3. *Bankruptcy Jurisdiction. 9,000 litigants in search of an authority*" and Copenhaver, *Summary Jurisdiction*, 41 **Ref. J.** 108 (October 1967).

Bankruptcy Act, Congress invested the bankruptcy courts with original jurisdiction ". . . to deal with the assets of the bankrupt they are administering". **Katchen v. Landy,** *supra* at 327.

This is such a case.

CONCLUSION

This case sharply projects issues basic to a bankruptcy court's jurisdiction and to ultimate dispositions in the administration of bankrupt estates.

The Supreme Court has noted its role in determining "the exact scope of summary proceedings in bankruptcy . . . in the absence of congressional definition . . . after due consideration of the Bankruptcy Act as a whole, as well as the particular provisions of the Act brought in question. . . ." **Katchen v. Landy,** *supra* at 328.

We respectfully submit this as a case in which certiorari should be granted. We urge the Supreme Court to grant the writ to resolve the formidable and novel conceptual difficulties which the Fifth Circuit's decision portends in the administration of the Bankruptcy Act.

R. CLIFFORD FULFORD
433 Frank Nelson Building
Birmingham, Alabama 35203
Attorney for Petitioner

Of Counsel:
MAX C. POPE
LEVINE, FULFORD & POPE
433 Frank Nelson Building
Birmingham, Alabama 35203

APPENDIX A-1

United States District Court
Northern District of Alabama
Western Division

In the Matter of:

American Southern Publishing Company, a Corporation, Bankrupt.	In Bankruptcy No. 5674-W

ORDER ON SPECIAL APPEARANCE AND OBJECTION TO SUMMARY JURISDICTION AND MOTION TO DISMISS PETITION OF THE TRUSTEE FOR TURN-OVER ORDER

The Trustee in Bankruptcy in this case (hereinafter referred to as Trustee) filed, on June 4, 1968, a Petition for a Turn-Over Order directed to The First National Bank of Mobile (hereinafter referred to as the Bank). The Bank filed herein, on June 18, 1968, a Special Appearance and Objection to Summary Jurisdiction and a Motion to Dismiss Trustee's Petition for a Turn-Over Order. A hearing was set, upon due notice to the parties and their attorneys, on July 8, 1968. On July 8, 1968, a hearing was held solely on the issue raised by the Special Appearance and Objection to the Summary Jurisdiction and Motion to Dismiss filed by the Bank. On this sole issue, evidence was submitted by the Trustee, by the Bank and testimony submitted by both parties. Admissions of fact (made by both parties) appearing of record were offered as evidence on behalf of both parties.

As at October 7, 1966, the date of the filing of the original petition in this case, there were certain books at the Publishers' Warehouse, a warehouse located in Jefferson

County, Alabama. A stipulation was made of record in this case on behalf of the Trustee and the Bank that the question of summary jurisdiction of this Court of the proceeds of the sale of said books be decided in the same manner as would be decided the question of summary jurisdiction of the Court over the books themselves. Meanwhile, the books were to be sold and the proceeds of such sales to be held by the Bank pending the decision now before the Court as to the jurisdiction of said books, and the right of the Trustee to have such books or the proceeds thereof turned over to him. Briefly stated, the Trustee's contention is that these books were, on October 7, 1966, in the actual or constructive possession of the Bankrupt and the Trustee and, therefore, that this Court has summary jurisdiction over them and the proceeds of their sale. Conversely, the Bank's special appearance and objection to the summary jurisdiction of the Court are based on the contentions that the Bank had, on October 7, 1966, actual or constructive possession of said books and that it had a claim more than merely colorable to said books, by virtue of a lien by way of pledge.

The parties submitted this case for a decision on this preliminary jurisdiction question on the evidence adduced at the hearing, as aforesaid, and upon the brief of the Bank, filed herein on July 18, 1968, and upon a letter of the Attorney for the Trustee, also submitted on July 18, 1968. The Court has carefully considered all of the evidence and the arguments of the parties and hereby makes the following findings of fact, conclusions of law, and order:

Findings of Fact

The Bankrupt, American Southern Publishing Company, a Corporation (hereafter sometimes called "Publisher"), engaged in business near Northport in Tuscaloosa County, Alabama, as a printer and publisher. Its principal source of income was from the sale of textbooks to the State of Alabama, some of which were exclusively adopted for use in its public schools. The Publishers' contracts with the State required the Publisher

> ". . . to consign to the State Textbook Depository established by the Board (State Board of Education) a sufficient quantity of textbooks or publications included in this contract to fill promptly all orders received from the State, County Boards of Education, City Boards of Education, and local agencies established by the Depository at not less than three places in each county in Alabama."

The contracts also required a bond of the Publisher for the performance of the contract and provided for a forfeiture of $100.00 a day to the State Board of Education for each day of the Publisher's failure to supply the State Textbook Depository with sufficient books to fill all orders received by the Depository from the State, County and City Boards of Education and local textbook agencies. The State reserved the right in such contracts to abrogate any provision in conflict with future laws of the State of Alabama as the Legislature might enact on the subject of school textbooks.*

On July 7, 1964, the Publisher entered into a "Depository Contract" with "State Textbook Depository, Division of EBSCO Investment Services, Inc." whose warehouse was and is located in Birmingham, Jefferson County, Alabama. Under this contract, the Publisher shipped on con-

* Footnotes appended hereto.

signment to the Depository its publications under contract of adoption by the State. The Publisher agreed to invoice all books to the Depository at the Publisher's net wholesale prices as stipulated in the contracts with the State. Insurance on the books in the Depository was at Publisher's expense. Ad valorem taxes on the books were the responsibility of the Publisher. The Publisher allowed the Depository a service charge equal to 8% of the net cash received from the sale of State-adopted books, and 10% on all other books sold.

The Depository agreed to maintain office, shipping and warehouse facilities in Birmingham sufficient to handle adequately the distribution of Publisher's titles within the State of Alabama and generally to handle properly the publisher's business; "5. To carry out as agent of the Publisher any contracts which the Publisher may make with the State or anyone else and to act at all times in the process of distribution for the Publisher's best interests"; "6.A. To hold stock shipped by the Publisher, as trustee for the Publisher"; and to account to Publisher and to permit Publisher to audit the Depository's books as they affect Publisher's business.

The contract provided for its cancellation if the State *Board of* Education cancelled its contract with the Depository.[2]

A Special Session of the Alabama Legislature enacted Act No. 221, approved April 20, 1965 [Title 52, Chapter 19A, Sections 433(17) through 433(45), inclusive, Alabama Code of 1940 (Cumulative Pocket Part of Code of Alabama [Recomp. 1958])], which abolished the State Textbook Depository. Sections 14, 15 and 17 of that Act (29), (30), (31) and (33) of Section 433 of Title 52 of the 1958 Recomp. Alabama Code), the parts here material, provide as follows:

"Section 14. The State Board of Education shall have no power or authority to enter into any contract or arrangement for furnishing textbooks or providing a depository for textbooks or delivering textbooks except as herein provided. All authority heretofore granted to the State Board of Education with respect to such matters is hereby revoked and the statutes granting such power and authority are hereby repealed. Any contract or arrangement hereafter made for acquiring or delivering textbooks otherwise than as specifically herein provided shall be null and void.

"Insofar as permitted by the Constitution of Alabama the terms and provisions of this Act shall govern when such terms and provisions are inconsistent with any contract or arrangement heretofore made for the acquisition and delivery of textbooks.

"Section 15. Upon receipt of a requisition from the State Superintendent of Education, the State Purchasing Agent shall, in accordance with existing statutes and procedures governing state purchases, issue a purchase order to the publisher who shall ship such books ordered to the local county or city board of education, shipping charges prepaid.

. . .

"Section 17. All books contracted for shall be shipped upon purchase orders of the State Purchasing Agent. The State Superintendent of Education shall upon receipt of a requisition for books from a county or city superintendent of education, either revise or return for revision or approve such requisition and forward same to the State Purchasing Agent. The publisher or publishing company, shipping such books, shall prepare quadruplicate invoices or bills for the books so shipped. One copy shall be mailed to the

State Superintendent of Education, and the other three to the county or city superintendent of education to whom the books are shipped."

On May 19, 1965, the Publisher and EBSCO Investment Services, Inc., entered into a new agreement which, after noting the cancellation of the above contract under the provisions thereof, renewed said contract upon the same terms and conditions.[3]

On August 24, 1966, the Publisher mailed a copy of its contract with Publishers' Warehouse to the Bank.[4]

On April 7, 1966, the Bank wrote the Publisher and, in an effort to collateralize Publisher's then outstanding indebtedness to the Bank, asked the Publisher to

"... make up an invoice covering the amount due you by the Educational Board. I do not have the correct name or I would make it up and write in the face of the invoice something like the following:

"'We hereby assign this invoice and the proceeds due from the transactions evidenced thereby to the First National Bank of Mobile, Alabama, as collateral security for an indebtedness now owing by us to it, and you are hereby authorized and requested to pay over and remit such proceeds direct to said bank for our account as aforesaid.

The American Southern Publishing Company

By: .....'

"It is my understanding from what you told me that the State will not accept the assignment and agree to remit the funds to us. But it would be our understanding with you that as soon as you receive the funds you will pay the amount due our bank . . ."[5]

On April 11, 1966, the Publisher sent the Bank its invoice to the State of Alabama for $53,102.22 worth of books endorsed as the Bank requested.[6]

On June 24, 1966, the Publisher wrote three letters purporting to assign to the Bank its textbook contracts with the State of Alabama covering the books named **Civics for Alabama Schools**, **Know Alabama** and **Alabama History for Schools**, "with payment to be made per agreement with letter to State Comptroller dated June 24, 1966."[7]

These books, as well as others here involved, were the subjects of contracts between the Publisher and authors requiring payment of royalties to the authors when books were sold by the Publisher. In connection with the purported "assignment" of the contracts with the State of Alabama, there was no assumption by the Bank of any of the obligations involved in the performance of such contracts. In particular, there was no agreement to perform any of the duties required of the Publisher, such as delivery of the books, provision of a bond, or to pay royalties to authors.

There is no act subsequently by any of the parties that breathed any life in the purported assignment of contracts, and this idea was abandoned *sub silentio*.

The Publisher's letter to the State Comptroller authorized the latter to forward all state checks payable to the Publisher to the Bank, "to be credited to an escrow account in the name of American Southern Publishing Company."[8] On June 25, 1966, the Publisher mailed to the Bank the authorization of June 24, 1966, to the State Comptroller, the textbook contracts, and an inventory referred to as "Notarized official warehouse receipts from Publisher's Warehouse", photocopies of which were later attached to all except one of the Publisher's collateral notes to the Bank.[9] These inventories, it is to be noted,

were not official warehouse receipts and were not exact in description of books in inventory, because of undetermined numbers of books previously sold from such inventory.

In a letter dated July 7, 1966,[10] the Publisher wrote Publishers' Warehouse that it had "concluded a working agreement" with the Bank for a loan, "and as a form of collateral we made a consignment of our inventory now warehoused in the Publisher's Warehouse." The letter directed that a duplicate shipping document of all shipments of "our inventory report dated March 31, 1966," be sent to the Bank, and stated that the Warehouse would be notified when the loan had been satisfied and a release "granted jointly" by the Publisher and the Bank. There was apparently some misdirection in the mailing of this letter. The Publisher's file indicates "Xerox copy to Mr. Pharr [President of the Bank] 7 13 66".[11] This letter apparently referred to the ineffective "assignment" of contracts. No "consignment" was made of inventory to the Bank. On July 21, 1966, the Bank wrote the Warehouse quoting the entire body of said letter and adding the following concluding paragraph:

> "We would prefer that your receipt be to our bank covering these books; but if that is not in line with your policy, we would want to know that you do recognize the assignment of your receipt by the American Southern Publishing Company which we hold. What we are trying to accomplish is that we want to know that these books will not be moved out except on order confirmed by us. Any suggestions to accomplish the above will be appreciated."[12]

In this letter, the Bank refers to an "assignment of your receipt". As we have noted, there was no warehouse receipt issued, only a certification of an inexact inventory. There was no purported assignment of receipt, the Pub-

lisher having signed only an abortive assignment of contracts, which it later referred to as a "consignment" of inventory. As of this point, no lien status was indicated, despite the ambiguous groping of the parties for some kind of arrangement to assure the Bank of repayment of advances.

On July 26, 1966, Publishers' Warehouse wrote the Publisher requesting a duplicate of the Publisher's letter of July 7, 1966, stating that the original had never been received.[13] On August 15, 1966, a Xerox copy of the requested letter dated July 7, 1966, was mailed by the Publisher to Publishers' Warehouse.[14]

On July 19, 1966, a loss payable clause was added to Publisher's fire insurance policy on the books providing that "any loss that may be ascertained and proven to be due the Insured [American Southern Publishing Company] under this policy shall be payable to First National Bank of Mobile, Mobile, Alabama, as their [sic] interest may appear, subject, nevertheless, to all conditions of the policy."[15]

On July 21, 1966, the State Superintendent of Education wrote the Bank acknowledging the receipt of the letter request from the Publisher to forward to the Bank all State warrants payable to the Publisher "to be credited to an escrow account in the name of American Southern Publishing Company." The letter advised that warrants were being forwarded to the Bank "as per your request", and that proper steps were being taken through the State Department of Finance, Division of Purchases and Stores, "to have future purchase orders issued to the American Southern Publishing Company and The First National Bank of Mobile as assignee . . ."[16]

On July 26, 1966, the Bank wrote the Publisher enclosing a copy of the letter from the State Superintendent of

Education which the Bank received with the first remittance of $370.22 credited by the Bank to "an account reading American Southern Publishing Company, Escrow Account, which will be applied toward the payment of your company's note to which your contract with the State of Alabama Department of Education has been assigned. We trust this is in line with our understanding."[17] On August 18, 1966, the Publisher wrote the Bank "to advise you that this is in complete accordance with my thinking."[18]

On August 8, 1966, attorneys for Publishers' Warehouse wrote attorneys for the Publisher enclosing proposed agreements and papers and stating:

> ". . . one agreement . . . resolves the dispute over claimed interest in the textbooks in the Warehouse and contemplates the execution of a separate agreement or security interest by American Southern.
>
> "This separate agreement is also enclosed. It is substantially the same as the prior agreement submitted to you except that Publishers' Warehouse's security interest has been subordinated to the claim of the bank with respect to the sales of textbooks to the State of Alabama."

The forms of agreement enclosed proposed to give a security interest to Publishers' Warehouse in the Publisher's books stored there, subordinate to the Bank's [illegible] which would have been paid first from sales to the [illegible] of Alabama only. The fact that such agreements [illegible] executed and were actually declined makes it [illegible]ary to consider what might have been the case [illegible]h agreements been executed and recorded.[19]

On August 15, 1966, the Publisher wrote the State Purchasing Agent, Finance Department, Purchases and Stores Division, directing that

". . . . all state warrants in payment of textbooks shipped to the State of Alabama from the American Southern Publishing Company will be annotated in the payee column as follows:

"'Payable to the First National Bank of Mobile, Alabama and the American Southern Publishing Company Escrow Account'

and mailed to the attention of Mr. H. Austill Pharr, President of The First National Bank of Mobile. This authorization is being granted for this to be done because of a financing program that has been established between our company and The First National Bank of Mobile.

"The above agreement cannot be terminated, without the permission of this company and The First National Bank of Mobile and will remain in effect until this mutual agreement has been granted."[20]

On August 18, 1966, the State Department of Finance, Division of Purchases and Stores, entered a purchase order change for books on the basis of "Letter 8-15-66" changing the name of the vendor to "The First National Bank of Mobile, Alabama, and the American Southern Publishing Company Escrow Account."[21]

On August 19, 1966, Publishers' Warehouse wrote the Bank and attached a list of the Publisher's books stored in its warehouse in Birmingham as of June 30, 1966, certifying that since then not in excess of $10,000.00 from those listed had been shipped. The letter approved and consented to by the Publisher, concluded with:

"We hereby agree, to the extent we can legally do so, that we will not ship any more of said books from our warehouse without your consent."[22]

This agreement by Publishers' Warehouse not to ship without the Bank's consent, was conditioned "to the ex-

tent we can legally do so." While this condition might include several contingencies, it clearly included the bailee's understanding that the books might be levied on in behalf of the Publisher-Bankrupt's creditors. (See testimony of the Bank's witness, Robert S. Selby, manager of Publishers' Warehouse.) This condition is, of course, inconsistent with a contention that the bailee by this instrument converted the possession of the books from the Publisher to the Bank. Agreement by the Publisher and by the Bank to the Warehouse letter with this condition included constitutes recognition and acceptance on their part of the expressly limited nature of the veto power granted the Bank.

Attorneys for Publishers' Warehouse delivered the above letter as an enclosure with a letter to the Bank also dated August 19, 1966, "only upon the condition that we contemporaneously received" a note and cash for a past due obligation owed to Publishers' Warehouse by the Publisher, and "upon a satisfactory agreement by the Bank with respect to remittance of warehouse fees due Publishers' Warehouse with respect to further shipments."[23]

On August 22, 1966, attorneys for Publishers' Warehouse wrote the Bank about orders it received for the Publisher's books from others than the State Department of Finance, pointing out that the Warehouse invoiced and received payment for such orders and accounted to the Publisher therefor quarterly for all such moneys less the Warehouse's commission of 8%. The Publisher was asked to instruct the Warehouse to remit moneys due quarterly to the Bank. The Warehouse requested the right to fill such orders without having to check with the Bank on each such order.

> "The Warehouse would, of course, continue to get your approval before making any shipment, payment

for which was not due to be made to the Warehouse—for instance, shipments to the State of Alabama or direct to American Southern . . . "[24]

By its letter to the Bank of August 24, 1966, the Publisher approved this procedure, sending copies to the Warehouse and its attorneys.[25] By its letter of August 31, 1966, to attorneys for Publishers' Warehouse, the Bank approved the arrangement

". . . with the understanding that any and all remittances for any books delivered subject to the contract between the publisher and the warehouse company would be remitted to us, as the books are assigned as security to our loan. Therefore, if you will prepare the type of letter necessary for either their or our joint signatures so that everyone will be protected, we will appreciate it."[26]

On September 12, 1966, Publishers' Warehouse wrote a joint letter to the Bank (which subscribed its agreement on September 15, 1966) and to the Publisher (which subscribed its agreement on September 14, 1966)

". . . to set forth in one document . . . the procedure which has been worked out for the handling of the textbooks of American Southern on hand in the Warehouse and for the distribution of proceeds derived from the sale of such textbooks . . .

"The procedure will be as follows:—

"1. Shipment of textbooks on orders from authorized agents appointed by county or city boards of education and from school boards or systems, principals, school teachers, and individuals in the State of Alabama, payment for which is due to be made to the Warehouse, will be made by the Warehouse without prior approval of the Bank or American Southern.

"2. Approval of the Bank will be obtained by the Warehouse before making shipment of any textbooks payment for which is not due to be made to the Warehouse.

"3. The Warehouse will remit to the Bank any monies due American Southern at the time of each quarterly report to American Southern, less commissions then due the Warehouse for shipments made.

"4. American Southern has directed and will cause the State of Alabama to remit to the Bank any monies due American Southern on account of the purchase of textbooks by the State of Alabama.

"5. The Bank will pay to the Warehouse 8% of the monies received by it on account of the purchase by the State of Alabama of textbooks from American Southern as the commission due the Warehouse under its agreement with American Southern.

"The procedure set forth above will continue in effect until the indebtedness of American Southern to the Bank and any accrued interest thereon is discharged in full."[27]

On September 14, 1966, the Publisher sent three signed copies of this agreement to the Bank for its execution and return of appropriate copies to the Publisher and Publishers' Warehouse. The forwarding letter referred to it as

"the agreement to be made between the American Southern Publishing Company, First National Bank of Mobile, and Publishers' Warehouse for the sale of American Southern books by Publishers' Warehouse . . . I think that this will get this matter cleared up."[28]

On September 15, 1966, the Bank wrote Publishers' Warehouse (mailing a copy also to Publisher) enclosing

> "letter signed by us and the American Southern Publishing Company agreeing to the conditions under which the books in storage at your warehouse are to be handled in the future. We are sending American Southern Publishing Company one copy and are retaining the other for our files."[29]

The Bank held a series of its printed collateral form notes executed by the Publisher on August 22,[30] 26,[31] 31(2),[32] September 1,[33] 2,[34] 8,[35] 14,[36] 20,[37] 27,[38] 30,[39] 1966 in varying sums totalling the principal indebtedness of $109,087.57 which the Bank claims the Publisher owed it. Each form note contained the following printed words considered here pertinent:

> "There has been deposited and pledged as collateral security for the payment of this note, or any other liability or liabilities of the undersigned to the owner thereof, whether the same be now existing or hereafter contracted, now due, or hereafter to become due the following property, belonging to the undersigned, to-wit:
>
> .....
>
> .....
>
> .....
>
> "And full power and authority is hereby granted to sell, assign or deliver the whole or any part thereof, or any substitute therefor, or any addition thereto at public or private sale, at the option of the owner or holder of this note, his, their or its assigns, on the non-performance of this promise, or non-payment of any of the liabilities above named, at any time or times thereafter, without advertisement or notice, which is hereby expressly waived, and at such sale the owner or holder of this note may purchase the whole or any part of said securities discharged from

any right of redemption or liability for conversion. In case of depreciation in the market value of the securities hereby pledged, or that may hereafter be pledged for the payment of this note, or if from any cause whatever said securities pledged shall cease to be satisfactory collateral to the owner or holder of this note for the debt, its renewal or substitute, the undersigned hereby agrees to deposit additional security from time to time as demanded, and failing to deposit additional security to the satisfaction of the owner or holder hereof, this note shall become due and payable for all purposes, and a sale of the collateral pledged may be made immediately as provided for above. The owner or holder of the debt may buy any of said collateral at private sale, with or without notice at the market price; and if there is no market price, then at its value; and the proceeds of any such sales shall be applied first to the payment of the expenses of making such sale, together with a reasonable attorney's fee, if any attorney is employed or consulted, second, to the payment of the principal debt hereby secured and the interest thereon; third, to the payment of any other debt, which the undersigned may now or hereafter owe to the owner or holder of this note, either as principal, surety, endorser, or otherwise, and if any surplus remains the same shall be paid to the undersigned."

All notes except the two dated August 31, 1966 (for $3,000.00 and $4,758.21, respectively),[32] and the notes dated September 1, 1966 (for $868.15),[33] and September 20, 1966 (for $6,014.48),[37] contained the following typed words in the space provided in the printed form for the description of the property:

"Books valued at $166,980.95 covered by Publishers' Warehouse Division of EBSCO Investment Services, Inc., receipt dated June 24, 1966. Copy of receipt attached hereto."

All of the notes except the note of September 20, 1966,[37] had attached thereto an identical photocopy of the inventory at Publishers' Warehouse as of March 31, 1966, of books published by American Southern Publishing Company, valued at $166,980.95. Said inventory contained a notarized certificate by the manager of Publishers' Warehouse dated June 24, 1966, as follows:

"State of Alabama
Jefferson County }

"I, Robert S. Selby, General Manager of Publishers' Warehouse division of EBSCO Investment Services, Inc., do hereby certify that the above and one attached sheet constitutes a complete inventory at Publishers' Warehouse of books published by American Southern Publishing Company and warehoused by Publishers' Warehouse as of March 31, 1966. I further certify that since March 31, 1966, to the best of my knowledge there has been withdrawn from the above inventory no more than $2,000.00 in wholesale value.

"Dated this 24th day of June, 1966.

/s/ Robert S. Selby

"Sworn to and subscribed before me this 24th day of June, 1966.

/s/ Marjorie M. Dobbs
Notary Public"

The oral testimony of Mr. Selby established that he had prepared this inventory at the request of the Publisher to whom he had sent it. As previously related, it was mailed by the Publisher to the Bank on June 25, 1966, with the textbook contracts and authorization to the State Comptroller to forward to the Bank all payments due to the Publisher.[40]

The "collateral" note of September 20, 1966, for $6,014.48[37] is unlike any of the others. In the space provided for the description of the property, there appears the following typed words:

> "Assignment in part of Invoice No. 16570 to State of Alabama for $6,537.48, less 8% due to be paid to Publishers' Warehouse, Division of EBSCO Investment Services, Inc., when invoice is paid. Copy of invoice attached hereto."

Attached to said note was an invoice to the State of Alabama from the Publisher for certain books sold to the State of Alabama for the total sum of $6,537.38 (which invoice also appears as Respondent's Exhibit 3 on the hearing of July 8, 1968).

Regarding the note dated September 1, 1966, for $868.15,[38] it was executed and mailed in its original form by the Publisher to the Bank on the same date[41] with the following words only appearing by typewriter in the blank space provided in the note for the description of property:

> "Reference to escrow account procedure in Warehouse inventory value for collateral."[42]

The notes of August 31, 1966, for $3,000.00 and $4,758.21, respectively,[39] also originally carried the same typing in said blank space, but on September 1, 1966, the Bank wrote the Publisher that if would like to have the wording on the collateral notes read as follows:

> "'Books valued at $166,980.95 covered by Publishers' Warehouse Division of EBSCO Investment Services, Inc., receipt dated June 24, 1966. Copy of receipt attached hereto.'"

The Bank informed the Publisher that it had "taken the liberty of inserting into these notes assignment of these books and in the future wish that you would follow the arrangement outlined about."[43]

The requested words were added by the Bank to the notes dated August 31, 1966,[32] and a copy of the inventory certified June 24, 1966, was attached to each note.

To the note of September 1, 1966, for $868.15,[33] the Bank added the following truncated wording:

> "Publishers' Warehouse Division of EBSCO Investment Services, Inc. receipt dated June 24, 1966. Copy of receipt attached hereto."

The full text of the wording requested by the Bank in its letter of September 1, 1966,[43] appeared in all other such notes.

On October 7, 1966, the Publisher filed its petition in this proceeding for an arrangement under Chapter XI thereafter converted to straight bankruptcy. The Receiver (now Trustee) made almost immediate demand on all parties concerned that all monies proceeding from the sale of Publisher's books in Publishers' Warehouse be sent to him instead of to the Bank.[44] At a hearing on October 31, 1966, all interested parties reached an agreement, approved by the Court, by and under which the books would be sold and the net proceeds from such sales deposited to the escrow account in the Bank without prejudice to any party, it being agreed that the net proceeds from the sale of such books would be substituted for the books and the rights of the parties later determined as if such money was in fact the books in question as of October 7, 1966.

The Court finds that as of October 7, 1966, the books sold on Purchase Order No. 6-86327 (DE-411) in the amount of $370.22,[45] and on Purchase Order No. 6-90263 (DE-584) in the amount of $6,537.48,[46] had been previously shipped from Publishers' Warehouse. All other shipments were made after October 7, 1966, by George Lewis Bailes, Jr., as Receiver or Trustee.

The Court is of the opinion that it does not have summary jurisdiction of the monies derived from the sales of books sold on Purchase Order No. 6-86327 (DE-411) and Purchase Order No. 6-90263 (DE-584) in the total amount of $6,907.70 for the reason that those books were shipped from Publishers' Warehouse before October 7, 1966. Consideration is therefore here limited to the sales of books physically located and present in Publishers' Warehouse on October 7, 1966, the sales of which produced the total net sum of $121,964.17.

Of this sum, $9,910.83 was the total net sum derived from Publishers' Warehouse's sales of books to others than the State of Alabama ($4,683.98 deposited December 22, 1966; $2,504.40 deposited May 10, 1967; $1,065.13 deposited August 10, 1967; and $1,657.32 deposited April 30, 1968). These were the sales Publishers' Warehouse made without the prior consent of the Bank, remitting the net proceeds to the Bank after deducting and retaining 8% from the gross received from such sales.

From information furnished to the Court since the hearing of July 8, 1968, pursuant to the Court's understanding with counsel for the parties, the Bank claims accumulated interest of $10,732.93 through April 8, 1968; and on July 12, 1968, the Bank paid the Trustee $9,051.37 representing the sum the Bank claimed its receipts from the sale of said books exceeded the amount of the principal and interest due to it from its alleged security interest in said books.

Accordingly, the sum of $112,912.80 (as possibly modified by computations of interest) is involved in the final decision of this proceeding.

The Bank admitted that none of its instruments or claimed securities had been recorded with any public official in the State of Alabama or of the counties of said State.[17]

The Bank also admitted that, as of October 7, 1966, there was nothing in the facilities of Publishers' Warehouse in Birmingham physically marking the books in question or indicating in any way that the Bank claimed to own or possess said books or any interest or security of any kind therein, including also in their admission a statement that there was nothing done at the Warehouse to indicate that anyone (including American Southern Publishing Company) owned the books or claimed any interest in them.[48]

Conclusions of Law

1. This Court has the right and duty to inquire into the question of possession, an issue of adverse claim being raised. 2 Collier on Bankruptcy, § 23.07, pages 519, 520 and cases cited.

2. The Bank, as of October 7, 1966, had more than a merely colorable contention or claim that it had a security interest in the books referred to in the Findings of Fact (except as noted in Conclusion of Law 8, below), but said claim or contention was not accompanied by actual or constructive possession of the property in which the security interest was claimed. Whether or not such contention or claim of lien may be maintained without such actual or constructive possession is not determined at this time, the sole issue before the Court at this time being the existence *vel non* of summary jurisdiction of the property. This issue is determined by the question of possession without reference to whether, upon complete submission of the Trustee's petition for turn-over order, such lien may be supported and valid as against the Trustee in Bankruptcy without actual or constructive possession.

3. The question of possession of the books is determined by the extent of the dominion or authority over the prop-

erty exercised or exercisable by the parties under the arrangements made between them and between them and Publishers' Warehouse, the bailee of the books in question. The Publishers' Warehouse was bailee for the Bankrupt originally and the facts do not indicate any action by any of the parties which was sufficient to change the possession by the bailee from its original character as possession for the Bankrupt.

4. The facts, as recited above, indicate that the parties involved were searching for an arrangement by which the Bank could advance monies to the Bankrupt, and obtain some assurance that it would receive the proceeds of the sale of the books in the Publishers' Warehouse. To this end, the Bankrupt and the Bank variously used language of assignment of contracts, consignment of inventory, assignment of invoice, and pledge. The language of the pledge form notes stating that "there has been deposited and pledged as collateral security", inserting an inexact inventory, was not in accordance with the facts. The books had long since been placed in Publishers' Warehouse under a contract clearly making the latter bailee solely for the Bankrupt. Nothing was done to change this relationship. So, putting to one side the question whether a valid pledge requires possession by the pledgee — not relevant to the preliminary jurisdictional question — here the actual possession was not changed.

The maximum claim of dominion exercised or exercisable by the Bank is based upon the letter, approved and consented to by the Bankrupt, from Publishers' Warehouse to the Bank to which was attached a list of books, some of which, but not all, were in the Publishers' Warehouse, in which the Publishers' Warehouse stated: "We hereby agree, to the extent we can legally do so, that we will not ship any more of said books from our warehouse without your consent". At no time did the Bank ask for or receive the authority to make affirmative di-

rections as to the disposition of the books. The quoted provision is solely negative in character and calls only for a refusal by the warehouse to ship in the normal course of business without the Bank's consent. This is an authority different in nature from the authority assumed by the pledgee in the case of **In Re Cross**, 244 F. 844 (D. C. N. Y. 1917), in which the authority over the property in question was that the goods be delivered only on releases signed by the bank pledgee. Under the language of the pledge agreement in **In Re Cross**, supra, the Bank clearly had authority to direct the delivery of the property to whomever it desired. Such authority is lacking in the present case. The negative power in the present case is most similar to a caveat where there is a mortgage on property not in the possession of the mortgagee, that a holder of such property not convey to a third party without the consent of the mortgagee. Such caveat obviously does not depend upon, or even imply, possession by or on behalf of an alleged pledgee or alleged lien-holder; any more than such a notice if the property were clearly and obviously in possession and control of its owner or any third person.

Between the facts of the **Cross** case and those of the instant case lies the dividing line between possession by a bailee for a pledgee and possession by a bailee for the original bailor. In the case of **In Re Cross**, supra, the pledgor did not retain the right to dispose of the property, whereas, in the present case, the debtor did retain such right. Indeed, in the instant case, it was the most earnest hope of all parties that the Bankrupt would continue to dispose of the books to its principal customer, the State of Alabama and to others. This was an arrangement designed not to warn creditors that the assets of the Bankrupt were subject to lien of any kind or to change selling arrangements, but to facilitate continued sale of the property by the bailor.

5. The Bank, for reasons satisfactory to it, and unnecessary to the decision here, refrained from interposing its possession in the process of handling Bankrupt's books. It worked out what was referred to as "agreements", "conditions" of handling, and "procedure" which were designed to route the proceeds of sale of the books into its hands. This procedure, had not bankruptcy or creditor proceedings intervened, was well designed to accomplish this purpose. But it did not, however the arrangement be characterized, take the constructive possession of the books away from the Bankrupt. This retained possession confers jurisdiction upon this Court of Trustee's Petition for Turn-Over Order.

6. The Bank did not have actual or constructive possession of any of the books deposited in Publishers' Warehouse by the Bankrupt on October 7, 1966, nor at any time prior or subsequent thereto.

7. On October 7, 1966, the Bankrupt and, subsequently, the Receiver and Trustee, had constructive possession of all of the books of the Bankrupt which had been theretofore deposited in Publishers' Warehouse by the Bankrupt.

8. As to $6,014.48 of the proceeds of sales of books being held by the Bank, being retained by virtue of an alleged pledge or note dated September 20, 1966 (Exhibit BB in the Special Appearance by the Bank) there can be no question that the Bank must turn over the proceeds of sale of such books, there being not even a colorable claim of lien by way of pledge of the books as to such note, because the note does not claim to be secured by books, but rather by "assignment of invoice" as to which assignment of invoice there is no evidence of recordation or other notice that would validate it. An order as to this, however, will be reserved until the Final Order on Trustee's Petition for a Turn-Over Order.

It is, therefore, Ordered by the Court that the Special Appearance and Objection to Summary Jurisdiction and the Motion to Dismiss the Trustee's Petition for a Turn-Over Order, filed herein by The First National Bank of Mobile be, and the same is, hereby overruled and denied, and the Court, finding that it has such summary jurisdiction of the Trustee's Petition for a Turn-Over Order directed to The First National Bank of Mobile, does hereby set for hearing the said petition of the Trustee in Bankruptcy for turn-over order on Monday, August 26, 1968, at 10:30 o'clock, A. M., in the hearing room at 629 Frank Nelson Building, Birmingham, Alabama.

Done this the 29th day of July, 1968.

s/ Herbert R. Maulitz
Herbert R. Maulitz
Referee in Bankruptcy

HRM:pm

Copies to:

Mr. George Lewis Bailes, Trustee; R. Clifford Fulford, Esquire, Attorney for Trustee; Messrs. Hand, Arendall, Bedsole, Greaves & Johnston, Attorneys for The First National Bank of Mobile; and John Morrow, Esquire, of Bradley, Arant, Rose & White, Attorneys for Publishers' Warehouse, Division of EBSCO Investment Services, Inc.

Footnotes

1. Exhibits A and B to Bank's Special Appearance.

2. First exhibit (not otherwise marked) to the Trustee's Petition.

3. Ibid., fn. 2, supra. See also Exhibit No. 4 to Trustee's Second Request for Admissions, a letter from Publishers' Warehouse to Publisher referring to Publishers' Warehouse as "an agent for American Southern".

4. Exhibit No. 12 to Trustee's Second Request for Admissions.

5. Exhibit No. 5 to Trustee's Second Request for Admissions.

6. Exhibit No. 6(1) and No. 6(2) to Trustee's Second Request for Admissions.

7. Exhibits C and D to Bank's Special Appearance; and Exhibit No. 7 to Trustee's Second Request for Admissions.

8. Exhibit E to Bank's Special Appearance.

9. Respondent's Exhibit 44 on the hearing of July 8, 1968.

10. Exhibit F to Bank's Special Appearance; Exhibit No. 8 to Trustee's Second Request for Admissions.

11. Exhibit No. 8 to Trustee's Second Request for Admissions.

12. Exhibit I to Bank's Special Appearance.

13. Exhibit No. 9 to Trustee's Second Request for Admissions.

14. Exhibit K to Bank's Special Appearance.

15. Respondent's Exhibits 51 and 52 on the hearing of July 8, 1968.

16. Exhibit H to Bank's Special Appearance.

17. Exhibit No. 10 to Trustee's Second Request for Admissions.

18. Exhibit No. 11 to Trustee's Second Request for Admissions.

19. Trustee's Exhibit 48 on the hearing of July 8, 1968.

20. Exhibit J to Bank's Special Appearance.

21. Exhibit L to Bank's Special Appearance.

22. Exhibit M to Bank's Special Appearance.

23. Exhibit N to Bank's Special Appearance.

24. Exhibit O to Bank's Special Appearance.

25. Exhibit P to Bank's Special Appearance.

26. Exhibit Q to Bank's Special Appearance.

27. Exhibit R to Bank's Special Appearance; also exhibited (not otherwise marked) to the Trustee's Petition.

28. Exhibit S to Bank's Special Appearance.

29. Exhibit No. 16 to Trustee's Second Request for Admissions.

30. Exhibit T to Bank's Special Appearance.

31. Exhibit U to Bank's Special Appearance.

32. Exhibits V and W to Bank's Special Appearance.

33. Exhibit X to Bank's Special Appearance; and Exhibit No. 13(2) of Trustee's Second Request for Admissions.

34. Exhibit Y to Bank's Special Appearance.

35. Exhibit Z to Bank's Special Appearance.

36. Exhibit AA to Bank's Special Appearance.

37. Exhibit BB to Bank's Special Appearance; see also and cf. Respondent's Exhibit 3 on hearing of July 8, 1968.

38. Exhibit CC to Bank's Special Appearance.

39. Exhibit DD to Bank's Special Appearance.

40. See fn. 9, supra.

41. Exhibit No. 13(1) to Trustee's Second Request for Admissions.

42. Exhibit No. 13(2) of Trustee's Second Request for Admissions.

43. Exhibit No. 14, Trustee's Second Request for Admissions.

44. From the testimony of George Lewis Bailes, Jr., at the hearing of July 8, 1968; and see the letter of October 14, 1966, from the Trustee to Publishers' Warehouse and the Bank exhibited to the Trustee's Petition.

45. Respondent's Exhibits 1 and 2, and Trustee's Exhibit 3 on the hearing of July 8, 1968.

46. Respondent's Exhibits 3, 4, 5, 6, 7, 8, and 9; and Trustee's Exhibit 4 on the hearing of July 8, 1968.

47. Trustee's first Request for Admissions, numbers 2(e) and (f), and the Bank's Responses thereto.

48. Trustee's first Request for Admissions, number 2(g) and the Bank's Response thereto.

APPENDIX A-2

United States District Court
Northern District of Alabama
Western Division

In the Matter of:

American Southern Publishing Company, a Corporation, Bankrupt.	In Bankruptcy No. 5674-W

ORDER ON PETITION OF TRUSTEE FOR TURN-OVER ORDER TO THE FIRST NATIONAL BANK OF MOBILE

The Trustee in Bankruptcy in this case (hereinafter referred to as Trustee) filed on June 4, 1968, a Petition for a Turn-Over Order directed to The First National Bank of Mobile (hereinafter referred to as the Bank). The Bank filed, on June 18, 1968, a Special Appearance and Objection to Summary Jurisdiction and a Motion to Dismiss Trustee's Petition for a Turn-Over Order. After notice and a hearing, at which evidence was submitted by the Bank and the Trustee, the Court, on July 29, 1968, made an Order overruling and denying the Special Appearance, Objection to Summary Jurisdiction, and Motion to Dismiss filed by the Bank. By letter of July 31, 1968, the Bank agreed to submit for order of the Court, upon the evidence already presented, the Trustee's Petition for Turn-Over Order, and petitioned for an extension of time to review the Order of July 29, 1968. On August 1, 1968, an extension of time to review the Order of July 29, 1968, was entered extending such time through the tenth day following the ruling on Trustee's Petition for Turn-Over Order. The Bank, on August 2, 1968, filed its Answer to Trustee's Petition for Turn-Over Order. The case is now submitted on Trustee's Petition for Turn-Over Order to the Bank.

Findings of Fact

The Court adopts the findings of fact in its Order of July 29, 1968.

Conclusions of Law

The Court adopts the conclusions of law contained in its Order of July 29, 1968, and, in addition, makes the following conclusions of law:

1. Under the law of Alabama, here applicable, a purported pledge is impotent to vest in a claimed pledgee any rights as against creditors where the pledgor has not been removed from possession of the purported pledged property and the right to sell the property, even though the sale is to be "as agent for" the alleged pledgee.

Lewis v. Bank of Mobile, 204 Ala. 689, 87 So. 176 (1920).

2. In this case the possession by Publisher's Warehouse, was the possession of his bailor, the Bankrupt.

Calhoun v. Thompson, 56 Ala. 166 (1876).

3. That possession of the pledge property by the pledgee is not required for the validity of a pledge, where the possession is by a third party who holds it for the pledgee, does not detract from the principle that possession by the pledgor or by a third party who holds it for the pledgor is inconsistent with the existence of a pledge.

4. As against creditors and the Trustee, the Bank had no valid or effective pledge of property of the Bankrupt in Publisher's Warehouse at the date of bankruptcy herein, October 7, 1966; nor any other valid or effective lien or security interest in said property or the proceeds of the sale of same.

5. The Bank is holding the proceeds of sales of such property, as referred to in Page 17 of the Order of this

Court of July 29, 1968, in the sum of $121,964.17, which should be turned over to the Trustee because it is property of this estate. In addition, by stipulation, certain interest on such funds is due to be paid by the Bank to the Trustee because by agreement such funds were being held in a savings account bearing interest to be paid on such funds, as proved to be due to the Trustee.

Order

It is, therefore, Ordered by the Court that the Bank turn over to the Trustee forthwith the sum of $121,964.17, together with interest thereon, jurisdiction being retained to determine, upon application of either party, the exact amount of interest in the event the parties are unable to agree as to such interest.

Done this 13th day of August, 1968.

/s/ Herbert R. Maulitz
Herbert R. Maulitz
Referee in Bankruptcy

HRM:pm

Copies to:

Mr. George Lewis Bailes, Trustee;
R. Clifford Fulford, Esquire, Attorney for Trustee;
Messrs. Hand, Arendall, Bedsole, Greaves & Johnston, Attorneys for The First National Bank of Mobile;
John Morrow, Esquire, of Bradley, Arant, Rose & White, Attorneys for Publishers' Warehouse, Division of EBSCO Investment Services, Inc.;
Messrs. Berkowitz, Lefkovits, Vann, Patrick & Smith, Attorneys;
and to all Authors or their Attorneys made parties to Trustee's Petition for Turn Over Order directed to The First National Bank of Mobile.

APPENDIX B

United States District Court for the Northern District of Alabama, Western Division

In the Matter of: American Southern Publishing Company, a Corporation, Bankrupt.	In Bankruptcy. No. 3674-W.

ORDER ON PETITIONS FOR REVIEW BY THE FIRST NATIONAL BANK OF MOBILE, ALABAMA

This case was filed as a proceeding under Chapter XI of the Bankruptcy Act on October 7, 1966. It was later converted to straight bankruptcy. During the course of these proceedings, the Trustee herein filed his petition before the Referees in Bankruptcy, to whom this case had been referred, calling upon The First National Bank of Mobile, Alabama (hereinafter referred to as the Bank), to turn over to the Trustee the sums on deposit in an escrow account in the Bank. This account holds the proceeds of sale of books, which, on October 7, 1966, were in the custody of Publishers' Warehouse, Division of EBSCO Investment Services, Inc. (hereinafter referred to as the Warehouse). Immediately after October 7, 1966, the Trustee (then the Receiver herein) notified the Bank that the books in the Warehouse belonged to the Bankrupt and claimed possession of said books for the benefit of the estate herein. The Bank claimed that the books in the Warehouse were impressed with a lien in its behalf and, until the debt secured by said alleged lien was satisfied, the books were not subject to the Trustee's demand. It being in the interest of both parties that the sale of these books not be interrupted pending the dispute of the parties, it was agreed that the books could be sold under the

arrangement that had previously been made by the Bank, the Bankrupt, and the Warehouse, and that the proceeds of the sale of the books would be held by the Bank in the same status and subject to the same rights of the parties as they had with respect to the books themselves.

The Bank filed its Special Appearance and Objection to Summary Jurisdiction and Motion to Dismiss the Trustee's Petition for Turn-Over Order and, after due notice, evidence was taken by the Referee with respect to the question of whether or not he had summary jurisdiction to decide the Trustee's Petition. On July 29, 1968, the Referee entered an order finding that the Court did have summary jurisdiction of the Trustee's Petition for Turn-Over Order, basing his decision primarily on the conclusion from the facts that the Bankrupt, and hence the Bankruptcy Court and the Trustee, had possession of the books in question on October 7, 1966. The parties then submitted the matter upon the Petition of the Trustee on its merits on the same evidence as was submitted upon the question of summary jurisdiction and, on August 13, 1968, the Referee in Bankruptcy held that the Trustee was entitled to the proceeds of the sale of the books which were in the Warehouse on October 7, 1966. From each of these orders of the Referee, the Bank has filed its separate Petition for Review and the Referee has separately certified to this Court each of these Petitions for Review.

Since these Petitions for Review contain issues of fact and law in common, both are considered and decided in this Order.

The Court has considered the record and evidence introduced before the Referee and finds that the findings of fact and conclusions of law of the Referee in each of the Orders herein (that is, the Order of July 29, 1968, relating to the summary jurisdiction of the Bankruptcy Court of the Petition of the Trustee for a Turn-Over Order directed

to the Bank; and the Order of August 13, 1968, deciding that the Bank should turn over to the Trustee the proceeds of sale of the books referred to) are justified by the evidence and the law; and the Court further finds that the findings of fact and conclusions of law entered in conjunction with each of said Orders are ample and include findings of fact and conclusions of law as to all matters appropriate and required to the decision of the matters dealt with by each of said Orders. This Court adopts the findings of fact and conclusions of law of each of said Orders of the Referee.

The Petition for Review in each review enumerated a number of objections to the Referee's Orders. Each of these has been carefully considered and none is found sufficient to indicate that either Order of the Referee be overruled or reversed. The Bank has emphasized several arguments that, therefore, deserve special mention. With reference to the issue of whether or not the Bankruptcy Court has summary jurisdiction of the controversy, the Bank contends that the Referee erred in determining the issue of possession because the Bank's contention with respect to possession of the books was more than merely colorable, and thus a block to summary jurisdiction. As to this, the Referee was correct in concluding that, as a matter of law, he had the right and duty to inquire into and decide the question of possession. A review of the leading cases authoritative here supports this view.

Taubel-Scott-Kitzmiller Co. v. Fox, 264 U. S. 426, 44 S. Ct. 396, 68 L. Ed. 770 (1924);

Matter of Tax Service Association of Illinois, 305 U. S. 160, 59 S. Ct. 131, 83 L. Ed. 100 (1938);

Chandler v. Perry, 74 F. 2d 371 (C. A. 5, 1934).

Our Fifth Circuit has had occasion to consider the tests as to the circumstances in which an adverse claim will defeat summary jurisdiction of the Bankruptcy Court in

Beneficial Finance Co. of New Jersey v. Ray, 328 F. 2d 55 (C. A. 5, 1964), quoting and citing **B. F. Avery and Sons Co. v. Davis**, 192 F. 2d 255 (C. A. 5, 1951), and citing **Spach, Trustee v. Fisher**, 310 F. 2d 328 (C. A. 5, 1962), to the effect that the good faith requirement as to adverse claim relates to the situation where the **claimant** had possession before bankruptcy?

These cases, as well as the case cited on this matter by the Bank, **Harrison v. Chamberlin**, 271 U.S. 191, 194; 70 L. Ed. 897, 899; 46 S. Ct. 467 (1926), support the proposition that only **after** an adverse claimant is shown to have possession of the property in issue does the existence of colorability of its claim become relevant to defeat the summary jurisdiction of the Court. As stated in 3 Collier on Bankruptcy (14th Edition), ¶ 23.07, page 521.

> "It is only where the possession is not in the bankruptcy court that the question of colorability of a claim is important."

citing cases to this effect: **Matter of Midland United Company**, 22 F. Supp. 751 (D. C., Del. 1938), and **Matter of American Fidelity Corp.**, 28 F. Supp. 462 (D. C., Cal. 1939); none shown to the contrary.

Both with respect to the question of summary jurisdiction and with respect to substantive question of the validity of the Bank's claim of lien, the Bank objects to the Referee's findings of fact as to the acts done by the parties (after the Bankrupt placed the books in the Warehouse, with the latter expressly holding them for the Bankrupt) which, it contends, changed the relationship of the Warehouse as bailee for the Bankrupt to one that created a condition of possession that would, on the one hand, defeat the summary jurisdiction of the Bankruptcy Court and, on the other hand, establish the validity of its claim of lien upon the books in the Warehouse. We find

the Referee's findings of fact, specifically at page 10 of the Order of July 29, 1968, a fair statement of the critical facts relating to this issue. A further detailing of the evidence would not appear to change the result. Specifically, the Referee found that the Bank had a form of veto power over the shipment of books from the Warehouse. The Bank would wish the Referee's findings of fact to recite a specific occasion where this veto power was brought into play. This detailing of evidence would not add to the finding that the veto power did, in fact, exist. That the evidence shows there were certain contractual commitments as between the Bankrupt, the Bank, and the Warehouse, relating to the procedure for dealing with the books in the Warehouse, which were honored and effective as between those parties, does not lead to a conclusion that the Bank had either deprived the Bankrupt of possession, or that the Bank had acquired sufficient rights to constitute a lien on the books. The Referee, from the evidence, concluded that the possession of the Warehouse, after the tri-partite arrangements between the Bankrupt, Bank and Warehouse, remained possession of the Bankrupt publisher and not possession of the Bank; as a consequence, the possession being in the Bankrupt, the Court had summary jurisdiction and the possession requirement for a valid pledge or other lien was not established upon the merits. We agree.

The Bank urges that **In Re Cross**, 244 F. 844 (D. C. N. Y. 1917) is here controlling because it ruled that a bank held a valid pledge where the pledged property was initially placed with a warehouse by the pledgor. The referee, however, properly distinguishes the **Cross** case. There the bank-pledgee assumed affirmative control of the property, while here the Bank did not.

The Bank also relies upon those authorities holding that a third person can hold possession of property con-

sistent with a valid pledge (Restatement of Security, Section 8; American Jurisprudence, **Pledge and Collateral Security**, Section 19), even where the third person is an agent of the pledgor. (**First National Bank of Parkersburg v. Harkness**, 42 W. Va. 156, 24 S. E. 548 (1896)). These authorities each make it clear that this principle relates to a factual situation where the third person's possession is converted by the acts of the parties to possession of the pledgee.

Finally, those cases cited for the proposition that there may be a valid pledge where the pledgee has no immediate right to actual possession are cases where: (1) the pledgee referred to is a subordinate pledgee, and (2) where the property is in possession of a prior pledgee, and **not** in possession of a bailee for the alleged pledgor. Those cases are distinguished from the case here because neither of these two conditions exists here. The subordinate pledgee cases are an exception to the rule that the pledgee should have possession, and that they are an exception is recognized in the cases cited by the Bank.

Gins v. Mauser Plumbing Supply Co., 53 F. Supp. 151 (D. C., N. Y. 1943);

Pierce v. National Bank of Commerce, 268 F. 487 (C. A. 8, 1920);

Schram v. Sage, 46 F. Supp. 381 (D. C., Mich. 1942).

Here, the Warehouse is not a pledgee or lien holder in any sense, and the Bank does not even contend it is a subordinate pledgee. Therefore, the exception does not apply. One of the essential elements of the exception does not apply, i. e., the alleged pledgor has not sufficiently surrendered dominion over the property to a superior pledgee. See 4A Collier on Bankruptcy (14th Edition), ¶ 70.86, page 980 (as quoted in the Bank's memorandum).

It is, therefore, Ordered by the Court that the Petitions of the Bank for Review of the Orders of the Referee in Bankruptcy herein of July 29, 1968, and August 13, 1968, respectively, be, and the same are, hereby overruled and denied, and this case is remanded to the Referees in Bankruptcy, to whom it has been referred, for further proceeding consistent with this Order.

Done, this the 30th day of January, 1969.

/s/ C. W. Allgood
United States District Judge

APPENDIX C-1

In the
United States Court of Appeals
for the Fifth Circuit

No. 27558

In the Matter of:
American Southern Publishing Company,
Bankrupt,
The First National Bank of Mobile,
Appellant,
versus
George Lewis Bailes, Jr., the Trustee,
Appellee.

Appeal from the United States District Court for the Northern District of Alabama

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(April 20, 1970)

Before Bell, Ainsworth, and Carswell,
Circuit Judges

OPINION

Bell, Circuit Judge: This appeal arises out of a turnover proceeding brought by a trustee in bankruptcy against The First National Bank of Mobile to recover funds derived from the sale of certain books. The trustee and the bank had previously stipulated that the books would be sold and that the question whether the bankruptcy court had summary jurisdiction would be decided

on the basis of the proceeds standing in lieu of the books.

The single issue to be resolved is whether the bankruptcy court correctly determined that the books were in the constructive possession of the bankrupt at the time of the initial petition in bankruptcy and, therefore, within that court's summary jurisdiction. The district court affirmed the ruling of the referee that summary jurisdiction was appropriate. We disagree.

The bankrupt, American Southern Publishing Company, a book publisher, entered into contracts with the State of Alabama to supply certain textbooks for the Alabama public schools. The books involved in the present case were held in an independent warehouse, Publishers' Warehouse Division of EBSCO Investment Services, in Birmingham pursuant to a depository contract between the bankrupt and the warehouse. Under that contract, the warehouse acted as bankrupt's agent in the distribution of the textbooks to the Alabama schools.

On June 24, 1966, at bankrupt's request, the warehouse prepared a certified inventory of bankrupt's books held by the warehouse. The bankrupt mailed this document to the bank on June 25, 1966, referring to it in a cover letter as "Notarized official warehouse receipts from Publishers' Warehouse."

On July 7, 1966, bankrupt wrote the warehouse that it had "concluded a working agreement" with the bank for a loan, "and as a form of collateral we made a consignment of our inventory now warehoused in the Publisher's Warehouse." The bank wrote the warehouse on July 21, 1966, asking that the warehouse recognize the assignment of the inventory by the bankrupt. The warehouse responded on August 19, 1966, in a letter to the bank as follows: "We hereby agree, to the extent we can legally do so, that we will not ship any more of said books from our warehouse without your consent."

On July 19, 1966, the bankrupt made the bank a loss payee under the fire insurance policy on the books in the warehouse. Bankrupt wrote the State of Alabama on August 15, 1966, directing that warrants in payment of textbooks be made payable to the bank, for the bankrupt's escrow account, and be mailed directly to the bank. The State complied with bankrupt's direction in this regard.

It became burdensome for warehouse to obtain bank's consent for small, individual orders from teachers for only a few books. Bank, bankrupt, and warehouse, therefore, agreed on September 12, 1966, that bank's consent would be unnecessary for these very small shipments, payment for which would be made to the warehouse. Such orders represented only a small percentage of total sales.

The warehouse consistently sought and obtained the bank's approval before books were shipped to Alabama school purchasers. Even when bankrupt itself needed textbooks to furnish as complimentary copies, it asked the bank to send its consent to the warehouse for the release of these books.

From August 22 to September 30, 1966, bankrupt executed ten promissory notes payable to the bank totaling $109,087.57. Each of the notes[1] stated that it was secured by the pledge of "Books valued at $166,980.95 covered by (warehouse's) receipt dated June 24, 1966. Copy of receipt attached hereto." The certified inventory prepared by warehouse was attached to each of the notes.

On October 7, 1966, bankrupt filed its petition in bankruptcy. The bank and the trustee then agreed that the books should be sold in the regular course of business

[1] The total amount of indebtedness which the bank claims to be secured by the pledge ($109,087.57) does not include a note executed on September 20, 1966, which purported to be secured by the assignment of an invoice to the State of Alabama. Consequently, that note is not a part of this case.

utilizing the procedures established before bankruptcy. They also agreed that the proceeds should be held by the bank in the same status and subject to the same rights of the parties as they had with respect to the books themselves. The trustee initiated this turn-over proceeding in the bankruptcy court, claiming that summary jurisdiction was appropriate because the books were in the constructive possession of the bankrupt at the time the bankruptcy petition was filed. The bank objected to the referee taking summary jurisdiction, contending that warehouse held the books for the bank rather than the bankrupt and that the books, therefore, were in the bank's possession.

After a hearing, the referee overruled the bank's objection to summary jurisdiction and, on the same evidence, ordered the bank to turn over the funds to the trustee. The bank filed petitions to review both the order denying the bank's objection to summary jurisdiction, and the order directing turn over. The district court affirmed the decision of the referee. We reverse.

It is settled that the Bankruptcy Courts have summary jurisdiction to adjudicate controversies relating to property over which they have actual or constructive possession. *Thompson v. Magnolia Petroleum Company*, 1940, 309 U. S. 478, 481, 60 S. Ct. 628, 84 L. Ed. 876. And at the outset of a bankruptcy proceeding, the referee has a right and a duty to inquire into and decide whether if has that actual or constructive possession which is essential to its jurisdiction to proceed. *Harris v. Avery Brundage Co.*, 1938, 305 U. S. 160, 163, 59 S. Ct. 131, 83 L. Ed. 100; *Taubel-Scott-Kitzmiller Co. v. Fox*, 1924, 264 U. S. 426, 433, 44 S. Ct. 396, 68 L. Ed. 770. The referee followed this procedure and it is the referee's holding that the facts constituted a showing of constructive possession in the bankrupt that is the subject of the dispute here. The

issue turns on the validity of this conclusion. There is no real dispute as to the underlying facts.

Upon the filing of a petition in bankruptcy, all of the property in the alleged bankrupt's actual or constructive possession is said to pass at once into the custody of the bankruptcy court and become subject to its summary jurisdiction. *Babbitt v. Dutcher*, 1910, 216 U. S. 102, 30 S. Ct. 372, 54 L. Ed. 402; *Mueller v. Nugent*, 1902, 184 U. S. 1, 22 S. Ct. 269, 46 L. Ed. 405. Section 70a(5) of the Bankruptcy Act, 11 USCA. 110a(5). See generally 2 Collier on Bankruptcy (14th ed.), ¶ 23.03 et seq.; and particularly ¶ 23.05. A court of bankruptcy, however, has no jurisdiction to adjudicate in a summary proceeding a controversy as to property held adversely to the bankrupt estate, without the consent of the adverse claimant. *Harrison v. Chamberlin*, 1926, 271 U. S. 191, 193, 46 S. Ct. 467, 70 L. Ed. 897.

In the instant case, the bank is an adverse claimant and the referee found the bank's claim to be substantial, and not merely colorable. A substantial claim alone does not, however, prevent summary jurisdiction; the question is possession.

The referee and the district court concluded that the warehouse originally was bailee for bankrupt and that the subsequent actions of the parties were not sufficient to change the possession by the bailee from its original character as possession for the bankrupt. The reasoning was that the bank obtained only a negative veto power without ever having the affirmative control over the books which was thought to be necessary for possession.

The proposition, if established factually, that property in the physical possession of a bankrupt's agent or bailee is in the constructive possession of the bankrupt would sustain summary jurisdiction. Here it is without dispute that bankrupt could not take actual possession of the books. The warehouse, under the agreements, could sur-

render possession to the bankrupt only with the approval of the bank. The books were being held by the bailee subject to the order of the bank.

The Second Circuit has held that summary jurisdiction over property in the hands of third parties rests on the condition that the property is in the possession of one who acknowledges that he holds it subject to the bankrupt's demand. *Buss v. Long Island Storage Warehouse Co.*, 2 Cir., 1933, 64 F. 2d 338. Judge Learned Hand stated for the court "that for the jurisdiction to attach, the bailee must be unconditionally subject to the bankrupt's orders." We agree with this statement of the law. See also *Green v. H. E. Butt Foundation*, 5 Cir., 1954, 217 F. 2d 553; *Goggin v. Consolidated Liquidating Corp.*, 9 Cir., 1951, 190 F. 2d 553; cf. *Jackson v. Sports Co. of Tex., Inc.*, 5 Cir., 1960, 278 F. 2d 716.

Here the bankrupt did not have unconditional control over the books in the hands of the warehouse. Indeed, the evidence indicates that bankrupt had little control if any at all. In bankrupt's words, they had been consigned to the bank as collateral. All actions relating to the books were subject to the bank's approval. The relationship between the bankrupt and the warehouse cannot support a finding of constructive possession. Summary jurisdiction was inappropriate.

This ruling is, of course, without prejudice to the resolution of the proper disposition of the contested funds in a plenary proceeding.

Reversed for dismissal of the turn-over petition in the bankruptcy court for lack of summary jurisdiction.

APPENDIX C-2

United States Court of Appeals
For the Fifth Circuit

October Term, 1969

No. 27558

D. C. Docket No. Bk. 5674-W

In the Matter of:

American Southern Publishing Company,

Bankrupt,

The First National Bank of Mobile,

Appellant,

versus

George Lewis Bailes, Jr., the Trustee,

Appellee.

Appeal from the United States District Court for the Northern District of Alabama.

Before: Bell, Ainsworth and Carswell, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Alabama, and was argued by counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said Dis-

trict Court in this cause be, and the same is hereby, reversed for dismissal of the turn-over petition in the bankruptcy court for lack of summary jurisdiction in accordance with the opinion of this Court.

It is further ordered that appellee pay to appellant, the costs on appeal to be taxed by the Clerk of this Court.

April 20, 1970

Issued as Mandate: June 3, 1970.

APPENDIX C-3

In the

United States Court of Appeals
For the Fifth Circuit

No. 27558

In the Matter of:
American Southern Publishing Company,
Bankrupt,
The First National Bank of Mobile,
Appellant,
versus
George Lewis Bailes, Jr., the Trustee,
Appellee.

Appeal From the United States District Court
For the Northern District of Alabama

On Petition for Rehearing and Petition for Rehearing En Banc

(May 25, 1970)

Before Bell and Ainsworth, Circuit Judges.

Per Curiam: The Petition for Rehearing is Denied and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the Petition for Rehearing En Banc is Denied.

Judge Carswell was a member of the panel originally deciding this case but did not participate in this decision.

APPENDIX D

CONSTITUTION AND STATUTES INVOLVED

No person shall . . . be deprived of . . . property, without due process of law. . . .

Constitution of the United States, Amendment V

28 U. S. C., § 1334. Bankruptcy matters and proceedings.

The district courts shall have original jurisdiction, exclusive of the courts of the States, of all matters and proceedings in bankruptcy.

The Bankruptcy Act (11 U. S. C., § 1, et seq.)

Chapter II

Courts of Bankruptcy

Section Two (11 U. S. C., § 11)

§ 2. Creation of Courts of Bankruptcy and Their Jurisdiction. a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

. . . .

(7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property

of any estate whenever under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; and where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction;

. . . .

(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act; . . .

. . . .

Section Twenty-Three (11 U. S. C., § 46)

§ 23. **Jurisdiction of United States and State Courts.** a. The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

b. Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant, except as provided in sections 60, 67, and 70 of this Act.

. . . .

Section Seventy (11 U. S. C., § 110)

§ 70. Title to Property. a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located

(5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered:

c. . . . The trustee shall have as of the date of bankruptcy the rights and powers of: (1) a creditor who obtained a judgment against the bankrupt upon the date of bankruptcy, whether or not such a creditor exists, (2) a creditor who upon the date of bankruptcy obtained an execution returned unsatisfied against the bankrupt, whether or not such a creditor exists, and (3) a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings upon all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists.

Alabama Code 1940 (Recomp. 1958), Title 52:

§ 433(30). Authority of state board to contract for furnishing, storing or delivering textbooks. The state board of education shall have no power or authority to enter into any contract or arrangement for furnishing textbooks or providing a depository for textbooks or delivering textbooks except as herein provided. All authority heretofore granted to the state board of education with respect to such matters is hereby revoked and the statutes granting such power and authority are hereby repealed. Any contract or arrangement hereafter made for acquiring or delivering textbooks otherwise than as specifically herein provided shall be null and void.

Insofar as permitted by the Constitution of Alabama the terms and provisions of this chapter shall govern when such terms and provisions are inconsistent with any contract or arrangement heretofore made for the acquisition and delivery of textbooks. (1965, 1st Ex. Sess., p. 296, 14, appvd. April 20, 1965.)

§ 433(31). Issuance of purchase orders; shipment of books by publisher. Upon receipt of a requisition from the state superintendent of education, the state purchasing agent shall, in accordance with existing statutes and procedures governing state purchases, issue a purchase order to the publisher who shall ship such books ordered to the local county or city board of education, shipping charges prepaid. (1965, 1st Ex. Sess., p. 296, 15, appvd. April 20, 1965.)

§ 433(33). Books to be shipped upon purchase orders of state purchasing agent; action of state superintendent upon receipt of requisitions; preparation and mailing of bills. All books contracted for shall be shipped upon purchase orders of the state purchasing agent. The state

superintendent of education shall upon receipt of a requisition for books from a county or city superintendent of education, either revise or return for revision or approve such requisition and forward same to the state purchasing agent. The publisher or publishing company, shipping such books, shall prepare quadruplicate invoices or bills for the books so shipped. One copy shall be mailed to the state superintendent of education, and the other three to the county or city superintendent of education to whom the books are shipped. (1965, 1st Ex. Sess., p. 296, § 17, appvd. April 20, 1965.)

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

No. 562

IN THE MATTER OF:
AMERICAN SOUTHERN PUBLISHING COMPANY,
Bankrupt,
GEORGE LEWIS BAILES, JR., the Trustee,
Petitioner,
versus
THE FIRST NATIONAL BANK OF MOBILE,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit

T. MASSEY BEDSOLE
3000 First National Bank Building
Mobile, Alabama 36602
Counsel for Respondent

Of Counsel
LOUIS E. BRASWELL
HAND, ARENDALL, BEDSOLE,
GREAVES & JOHNSTON
3000 First National Bank Building
Mobile, Alabama 36602

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Statutes

The Bankruptcy Act [11 U.S.C. §1, et seq.]
§2a(7) [11 U.S.C. §11(a)(7).]

STATEMENT OF THE CASE

The decisions below dealt with and determined the status of certain books stored in an independent warehouse in Birmingham, Alabama (Publishers' Warehouse Division of Ebsco Investment Services, Inc., herein called Warehouse). Shortly after the initial petition in this proceeding (initially Chapter XI but later converted to straight bankruptcy) was filed on October 7, 1966, the Trustee claimed that at the time the petition was filed the Bankrupt, a publisher doing business approximately sixty miles from Birmingham in the town of Northport, was in constructive possession of the warehoused books. The First National Bank of Mobile (Bank) claimed that the books had been pledged to the Bank as collateral security. Acknowledging the claims of each other, the Trustee and the Bank with the approval of the Referee entered into a stipulation that the books would be sold and the sale proceeds would be deposited in a special account with the Bank, all without prejudice to the parties' rights to decide their controversy as though the books were still stored at the Warehouse, including the right of the Bank to object to the jurisdiction of the bankruptcy court.

This case originated when the Trustee later filed a turnover proceeding against the Bank to require the Bank to deliver to the Trustee the funds derived from the sale of the books. The Bank, claiming that the books had been pledged as collateral security, objected to the Referee's summary jurisdiction. After a hearing the Referee overruled the Bank's objection to summary jurisdiction and later on the same evidence ordered the Bank to turn over the funds. The District Court upheld the Referee. The Bank appealed, and the Fifth Circuit Court of Appeals reversed, holding that the Bankrupt did not have constructive possession of the books as they were being held by the Warehouse subject to the order of the Bank. The opinion of the Fifth Circuit stated that its ruling was "without prejudice to

the resolution of the proper disposition of the contested funds in a plenary proceeding."

With respect to the key issue of possession the parties have advanced conflicting contentions. The Trustee maintains that the initial relationship established by the depository contract between the Bankrupt and the Warehouse, whereby the Warehouse held the Bankrupt's books as its "trustee" and "agent," was never changed. The Bank maintains that the relationship was changed by a pledge arrangement worked out among the Bankrupt, the Warehouse, and the Bank during the several months prior to the filing of the initial petition on October 7, 1966.

In view of these conflicting contentions, we think it is desirable to list the developments which occurred in connection with the pledge arrangement and which we feel changed the relationship between the Warehouse and the Bankrupt from what it initially was. The following developments, which were proved by the undisputed evidence (mostly documents but some undisputed and uncontradicted oral testimony), occurred in connection with the pledge arrangement:

(1) The Bankrupt sent to the Bank on June 25, 1966, a certified inventory of the Bankrupt's books held by the Warehouse as of June 24, 1966. At the Bankrupt's request the certified inventory, which the parties referred to in their correspondence and in the collateral notes as a "receipt," was prepared by the Warehouse on June 24, 1966.

(2) The Bankrupt wrote the Warehouse on July 7, 1966, that a "working agreement" had been made with the Bank "for a loan and as a form of collateral we made a consignment of our inventory now warehoused in Publisher's (sic) Warehouse."

(3) On July 19, 1966, the Bankrupt made the Bank a loss payee on the fire insurance covering the warehoused books.

(4) The Bank wrote the Warehouse on July 21, 1966, asking the Warehouse to recognize the Bankrupt's assignment of the "receipt" to the Bank and further stating: "What we are trying to accomplish is that we want to know that these books will not be moved out except on order confirmed by us."

(5) On August 19, 1966, the Warehouse wrote a letter to the Bank which was signed by the Bankrupt prior to mailing to signify its approval. The letter from the Warehouse stated: "We hereby agree, to the extent we can legally do so, that we will not ship any more of said books from our warehouse without your consent." A list of the warehoused books on hand was attached to the letter.

(6) Between August 22 and September 30, 1966, the Bankrupt executed a number of collateral promissory notes in favor of the Bank which stated that the notes were secured by a pledge of the warehoused books. The notes had attached to them a copy of the certified inventory prepared by the Warehouse on June 24, 1966 showing the dollar volume of the warehoused books as of that date and itemizing the books by title and quantity.

(7) After it became obvious to the Warehouse that it would be burdensome to obtain the Bank's consent in connection with small orders from individual teachers for only a few books, the three parties (Bankrupt, Warehouse and Bank) executed a letter-agreement of September 12, 1966, whereby consent of the Bank remained necessary except for very small shipments,

the payments for which would be made to the Warehouse and then remitted by the Warehouse to the Bank. As the Warehouse's manager testified, such orders represented "just a small percentage of the sales."

(8) On September 6, 1966, and again on September 17, 1966, when the Bankrupt itself wanted some of the warehoused books, the Bankrupt wrote the Bank requesting that the Bank give its consent to the Warehouse so that the Warehouse would ship some of the books back to the Bankrupt.

(9) On September 21, 1966, the Bank wrote the Warehouse, with a carbon copy to the Bankrupt, authorizing the Warehouse to ship the requested books to the Bankrupt. As to the necessity of the Bank's consent, the manager of the Warehouse testified at the hearing as follows: "I would not make shipment until I received a letter from [the Bank's president] in Mobile stating to release them to them and after I had received the letter from him, we made shipment to [the Bankrupt] in Northport, Alabama."

(10) On September 26, 1966, the Bankrupt wrote the Bank asking the Bank to give its approval to the Warehouse so that a shipment of books could be made to a purchaser.

(11) On September 27, 1966, in response to the Bankrupt's letter of September 26, the Bank wrote the Warehouse, with a carbon copy to the Bankrupt, stating: "This will authorize you to deliver these books."

(12) On September 28, 1966, after the Warehouse received the above letter from the Bank, the Warehouse shipped the books to the purchaser.

It was under this arrangement that the Bankrupt, the Bank, and the Warehouse were working when the initial petition was filed on October 7, 1966.

ARGUMENT

I. REPLY TO TRUSTEE'S FIRST ARGUMENT

The Trustee's first argument is based upon what the Trustee thinks is an inconsistency in the opinion below, namely that the question of possession was resolved against the Trustee and yet the opinion states that "(t)his ruling is, of course, without prejudice to the resolution of the proper disposition of the contested funds in a plenary proceeding." The Trustee first states (and we think correctly) that, although the procedural holding of the opinion is that summary jurisdiction was not appropriate, the finding that the Bankrupt did not have constructive possession of the books, which was essential to the holding, will be binding as between the parties in any subsequent proceeding in which the question of possession of the books is present. Since the Fifth Circuit has ruled that the Bankrupt did not have constructive possession of the books but also has stated that this ruling is to be "without prejudice to the resolution of the proper disposition of the funds in a plenary proceeding," the Trustee argues that a "novel jurisdiction enigma" exists.

The Trustee makes two separate suggestions, which are somewhat contradictory, as to why the Fifth Circuit fell into what the Trustee claims is the inconsistency which constitutes the "enigma." One suggestion (which like the other is made by questions rather than by declaratory statements) is that the Fifth Circuit was negligently unaware of the principles or res judicata and collateral estoppel which would have the effect of making conclusive as between the parties the finding that the Bankrupt did not have constructive possession. The other suggestion is that the "without prejudice" provision of the opinion indicates that the Fifth Circuit must really have meant to decide the possession question in favor of the Trustee, otherwise the decision would not be "without prejudice" to the Trustee. Both of these suggestions sell the Fifth Circuit short.

The obvious meaning of the "without prejudice" provision, which the Trustee has misread, is that the dismissal of the summary proceeding below does not also work a dismissal of the Trustee's plenary suits. The Trustee will still be able to seek the relief sought in the plenary suits so long as the relief and the attendant findings and conclusions are not in conflict with the Fifth Circuit's finding that the Bankrupt did not have constructive possession of the books.

Since the plenary suits have been mentioned in the Trustee's petition and since the Fifth Circuit was fully aware of their nature (the Trustee having attached copies of the complaints to a brief filed with the Fifth Circuit), we believe we are justified in informing the Supreme Court of certain pertinent facts concerning the plenary suits. They seek to set aside the Bank's (alleged) pledge as a voidable preference, and they were filed (one in state court and one in federal court to be sure of appropriate jurisdiction) as precautionary measures to guard against the running of the statute of limitations. At the time they were filed the Referee in this proceeding had already overruled the Bank's objection to summary jurisdiction and had already rendered a decision on the merits ordering the Bank to turn over the funds.

The clear effect of the Fifth Circuit's "without prejudice" ruling, which is not enigmatic in any way, is that the finding by the Fifth Circuit that the Bankrupt did not have constructive possession and the resultant order that the turn-over petition be dismissed will not prevent the Trustee from being able to prosecute his plenary suits which seek to set aside the Bank's pledge as a voidable preference.

(One of the Trustee's statements in the argument implies a concern that the Bank in the plenary suits, in an attempt to defeat their jurisdiction, might reverse its position by claiming that it had no pledge. Later in the argument the Trustee seems

to satisfy himself that the principles of res judicata and collateral estoppel would not allow the Bank to make this reversal. However, in case any doubt still remains, the Bank hereby assures the Trustee that it will make no claim that it had no pledge.)

II. REPLY TO TRUSTEE'S SECOND ARGUMENT

The Trustee's second argument, similar to the first, is that the Fifth Circuit has denied the Trustee due process because the holding that the Bankrupt did not have constructive possession of the books has foreclosed the Trustee from being able in the plenary suits to contend that constructive possession did exist. The Trustee argues that this "denial of due process" by the Fifth Circuit was unintended in view of the statement in the opinion below that the ruling was to be "without prejudice to the resolution of the proper disposition of the contested funds in a plenary proceeding."

We again point out, as was done in more detail in our reply to the Trustee's first argument, that the relief sought by the plenary suits is to set aside the pledge as a voidable preference. The purpose of the plenary suits was fully known by the Fifth Circuit because copies of the complaints were attached to one of the Trustee's briefs and because the Trustee in the brief described the nature of the suits.

Since the Fifth Circuit knew that the plenary suits sought to set aside the pledge as a voidable preference, the Trustee is clearly in error in claiming that the Fifth Circuit unintentionally denied the Trustee due process by foreclosing the Trustee from being able to litigate the question of constructive possession again in the plenary suits. It is obvious that the intent of the "without prejudice" provision in the Fifth Circuit's opinion was that the dismissal of the turn-over proceeding would not prevent the Trustee from maintaining the plenary suits to set aside the pledge as a voidable preference. It is equally obvious that the

Fifth Circuit did not intend by the "without prejudice" provision to permit the Trustee to litigate again the validity *vel non* of the pledge, although the Trustee's claim of denial of due process is based upon the contention that such was intended.

III. REPLY TO TRUSTEE'S THIRD ARGUMENT

The Trustee's third argument is entirely predicated upon the proposition that "the Fifth Circuit failed to find from undisputed facts that the Bank had even constructive possession." From this predicate the argument is made that summary jurisdiction is appropriate notwithstanding the Fifth Circuit's finding that the Bankrupt did not have constructive possession. In the course of the argument a number of cases from other circuits, which the Trustee states are in conflict with the opinion below, are cited for the principle that summary jurisdiction exists as to property in the hands of a third person who makes no claim if the other claimants to the property do not have constructive possession.

The Trustee is plainly wrong in his predicate. A number of statements in the opinion make it clear that the Fifth Circuit found the Bank to have constructive possession. Let us examine some of these statements. First, speaking of the Bank's contention with respect to summary jurisdiction, the court notes that the Referee himself found the Bank's claim to be substantial. Then this statement is made: "A substantial claim alone does not, however, prevent summary jurisdiction: the question is possession." Next the court notes that the Referee and the District Court felt that the Bank had "only a negative veto power." Then this paragraph appears:

> "The proposition, if established factually, that property in the physical possession of a bankrupt's agent or bailee is in the constructive possession of the bankrupt would sustain summary jurisdiction. Here it is without dispute that bankrupt could not take actual possession of the

> books. The warehouse, under the agreements, could surrender possession to the bankrupt only with the approval of the bank. *The books were being held by the bailee subject to the order of the bank.*" (Emphasis added)

Then finally this statement is made concerning the books: "In bankrupt's words, they had been consigned to the bank as collateral [the Bankrupt's president, a layman, having stated in a letter to the Warehouse that a "working arrangement" had been made with the Bank and that "as a form of collateral we made a consignment of our inventory" now in the Warehouse]."

It is inescapable that the Fifth Circuit found the Bank to have constructive possession of the books. What else could be meant by the statement "(t)he books were being held by the bailee subject to the order of the bank."? See *In Re Cross*, 244 Fed. 844 (N.D.N.Y. 1917). The statement is tantamount to a statement that the bank had constructive possession. This especially is the case when one considers the preceding statement, namely that with respect to the Bank's claim "the quest[illegible]s possession," that t[illegible] the District Court reasoned that the Bank had [illegible] veto power," and that "it is without dispute that bankrupt could not take actual possession of the books." Additional proof of the court's finding that the Bank had constructive possession is the statement, adopting the language used in one of the letters from the Bankrupt's president to the Warehouse, that the books had been "consigned" to the Bank as collateral. In reaching its conclusion the Fifth Circuit was adhering to the following principle of construction which appears in *Citizens' Bank & Trust Co. vs. Thornton*, 174 Fed. 752, 761 (5th Cir. 1909):

> "It is the duty of the courts to construe and enforce pledges according to the intent of the parties as gathered from the instrument of pledge or deposit, and the subject-matter and course of dealing to which it relates."

The cases cited by the Trustee have absolutely no bearing on the proposition upon which the Trustee's argument is predicated, namely that the Fifth Circuit failed to find that the Bank had constructive possession of the books.

In connection with constructive possession and pledges, we wish to point out several basic principles of law. A valid pledge exists when the pledged property is in the hands of a third person who has been notified of the pledge by either the pledgor or the pledgee. 41 AM. JUR. *Pledge and Collateral Security* §19 (1956); RESTATEMENT, SECURITY §8 (1941); *Pierce vs. National Bank of Commerce*, 268 Fed. 487 (8th Cir. 1920). The third person can even be the agent or employee of the pledgor. 41 AM. JUR. *Pledge and Collateral Security* §20 (1956).

IV. REPLY TO TRUSTEE'S FOURTH ARGUMENT

The Trustee's fourth argument is that the Bank's claim is insubstantial because the Bank did not have "such possession as to signify 'to the world what property was and what property was not pledged.'" Hence, the argument concludes, summary jurisdiction is appropriate even though the Bankrupt did not have constructive possession of the books at the time the initial petition was filed on October 7, 1966.

Our first reply to the argument concerning the insubstantiality of the Bank's claim is that the Referee himself, although he held summary jurisdiction was appropriate, conceded as a matter of law that "(t)he Bank, as of October 7, 1966, had more than a merely colorable contention or claim that it had a security interest in the books . . ." (page A-21 of the Petition). The Referee then went on to hold that the Bankrupt had constructive possession of the books, a holding diametrically contrary to that of the Fifth Circuit. We submit that the Trustee's argument that the Bank's claim is insubstantial is severely undercut by the Referee's own conclusion of law that the Bank had more than

a merely colorable contention or claim.

Our further reply is that the Trustee, in arguing the Bank's claim to be insubstantial, is confusing two different pledge situations. Let us examine these two situations before considering the specifics of the Trustee's argument.

One pledge situation, which is vastly different from the case at bar, exists when the pledged property remains on the premises of the pledgor-debtor. Field warehousing arrangements and factoring arrangements are characteristic of this type of pledge. Among the pertinent considerations are whether the pledgor-debtor had access to and dominion over the property, whether adequate fences and barriers existed, whether adequate signs were present to give notice of the pledge, and the like. In such cases the key issue is whether the creditors of the pledgor-debtor might have been deceived by the existing circumstances and by the pledgor-debtor's apparent ownership of the property.

The other pledge situation, of which the case at bar presents an example, exists when the pledged property is in the actual possession of a third person. (Of course, there is a third pledge situation which occurs when the property is in the actual possession of the pledgee-creditor, but this is not pertinent to our case or to the arguments made by counsel.) The authorities fully recognize that a valid pledge can exist when the pledged property is in the possession of a third person. RESTATEMENT, SECURITY §8 (1941); 41 AM. JUR. *Pledge and Collateral Security* §19 (1956); *Pierce vs. National Bank of Commerce*, 268 Fed. 487 (8th Cir. 1920). It is also well established that a valid pledge can exist even though the third person holding possession of the pledged property is the agent of the pledgor-debtor. 41 AM. JUR. *Pledge and Collateral Security* §20 (1956).

Different rules pertain to a pledge of property which, on the one hand, remains on the pledgor-debtor's premises, and a pledge

of property which, on the other hand, is in the possession of a third person. The case of *Pierce vs. National Bank of Commerce, supra,* explains these rules and the reasons for them. The following language is relevant:

> "One of the reasons, and probably the chief reason, for the alleged general rule that a deposit of the thing pledged is an indispensible attribute of a valid pledge, is that such a pledge is indispensible to prevent the possession by the pledgor of the thing pledged from giving to him a false credit, just as the failure to deliver personal property sold causes a false credit to the vendor and avoids the sale. This reason, however, ceases when at the time of the pledge the thing pledged is not in the possession of the pledgor, but is in the possession and control of a third party. On this account, probably, the authorities disclose the fact that in cases of the second class [those in which the property pledged was at the time of the alleged pledge in the actual possession or control of some third party]; of which the case at bar is one, an exception to the general rule of the necessity of the delivery of the thing pledged to the pledgee in order to make a valid pledge early arose, and has continued in strength and breadth, until it has now become as general as the rule itself, an exception to the effect that, when the thing pledged was in the possession or control of the third party at the time of the alleged pledge, it might be effectually pledged by the owner of it, or by the owner of an interest in it, without any change of possession or control of it, if notice of the fact of the pledge was given to the party in possession." 268 Fed. 492, 493.

The Trustee, confusing the two types of pledge situations, relies almost entirely upon cases in which the pledged property remained in the actual possession of the pledgor-debtor, as an examination of the cases will reveal. In *Security Warehousing*

Co. vs. Hand, 206 U.S. 415 (1907) there was a field warehousing situation. The field warehousing company leased a portion of the bankrupt's premises from the bankrupt, but the bankrupt continued to occupy the premises and continued to have actual possession of the property even after warehouse receipts were issued. In *Whitney vs. Wenman*, 198 U.S. 539 (1905) the property, which was goods and merchandise, remained on the premises of and under the control of the debtor. Although the debtor leased a few sales rooms to the warehouse company for $1.00 a year, the debtor still continued to exhibit the goods and merchandise and to handle them as beforehand. (It should be noted that in this case the holding was that there was plenary jurisdiction; the court did not even undertake to determine whether summary jurisdiction would have been appropriate.) In *Sweetnam vs. Edmund Wright Ginsberg Corporation*, 128 F.2d 1 (2nd Cir. 1942) there was an alleged factoring arrangement on the premises of the bankrupt. Inside the bankrupt's plant, consisting of thirty buildings on a fifteen acre site, about five of the buildings were utilized by the factor. However, the bankrupt continued to have access to these buildings. In *Casey vs. Cavaroc*, 96 U.S. 467 (1878) the securities, which were the property allegedly pledged, remained in the actual possession and control of the debtor inside the debtor's banking house, and this fact was the basis of the court's decision that a valid pledge did not exist. The concluding remarks of the court make it obvious that the pledge would have been valid had the property been in the actual possession of "a third person agreed upon by the parties." The concluding remarks are (page 491): "On this ground, therefore, of want of possession in the pledgee, or of a third person agreed upon by the parties, and of actual possession and control in the pledgor, we feel compelled to hold that the [creditor had no pledge valid as against third persons]." The cases of *Corn Exchange National Bank & Trust Co. vs. Klauder*, 318 U.S. 434 (1943) and *Benedict vs. Ratner*, 268 U.S. 353 (1925) dealt not with pledges but with accounts receivable

financing, and they, therefore, are not relevant. The case of *Lindsey-Robinson & Company vs. Grady*, 282 F.2d 607 (4th Cir. 1960) was not a pledge case either; the security device considered by the court was a chattel mortgage.

The Trustee's argument, which claims that the decision below "will shake the purpose and foundation of recording statutes," fails to realize that the principles of field warehousing and factoring do not apply when the pledged property is not in the actual possession of the pledgor-debtor but is in the actual possession of a third person. The reason, as was expressed in the case of *Pierce vs. National Bank of Commerce, supra*, is that when the property is in the actual possession of a third person, creditors are not likely to be misled by the pledgor-debtor's apparent ownership, as might be the case if the pledged property were still on the premises of the pledgor-debtor. As to the Trustee's claim that the decision below "will shake the purpose and foundation of recording statutes," we remind the Trustee that recording statutes historically have been inapplicable to pledges, which are accomplished by possession, including possession by third persons. As was stated in the case of *Union Bank & Trust Company vs. Azar*, 316 F.2d 433 (5th Cir. 1963): "Recording is constructive notice. So also is possession."

Since the books in the case at bar were stored not on the premises of the pledgor-debtor but in an independent warehouse approximately sixty miles away, the principles governing pledges of property remaining on the premises of the pledgor-debtor are inapplicable and do not render the Bank's claim insubstantial. To the contrary, the substantiality of the Bank's claim, which the Referee himself acknowledged, is supported by the principles of law which permit valid pledges to exist when the property is in the possession of a third person who is given notice of the pledge, and is supported by the pertinent facts of this case, namely that notice was given to the third person of the pledge,

that the third person made an acknowledgment to the pledgee, and that the third person took action with respect to the property only in response to correspondence from the pledgee.

V. REPLY TO TRUSTEE'S FIFTH ARGUMENT

The Trustee's fifth argument is that the decision below thwarts the policy of Congress, expressed in the Bankruptcy Act, favoring efficient and inexpensive administration of bankruptcy cases. The Trustee contends that trustees in bankruptcy sometimes are forced to "thrust and probe" to determine whether summary jurisdiction exists, and if it does not, "they must start over in a plenary proceeding."

This argument overlooks the fact, recognized by the Supreme Court, that Congress has not provided, although it has the power to do so, that bankruptcy courts shall have summary jurisdiction to determine the validity of substantial adverse claims to property not in the bankrupt's possession. See *Cline v. Kaplan*, 323 U.S. 97 (1944). In *Taubel-Scott-Kitzmiller Co. vs. Fox*, 264 U.S. 426 (1924), in which it was held that summary jurisdiction was not appropriate, the following language appears:

> "Congress has, of course, power to confer upon the bankruptcy court jurisdiction to adjudicate the rights of trustees to property adversely claimed. In matters relating to bankruptcy its power is paramount. Hence, even if the property is not within the possession of the bankruptcy court, Congress can confer upon it, as upon any other lower federal court, jurisdiction of the controversy, by conferring jurisdiction over the person in whose possession the property is. Congress has, also (subject to the constitutional guaranties), power to determine to what extent jurisdiction conferred, whether through possession of the res or otherwise, shall be exercised by summary proceedings and to what extent by plenary suit. But Con-

gress did not, either by §2, §23 of the Bankruptcy Act of 1898 or any other provision of the act, confer generally such broad jurisdiction over claims by a trustee against third persons." 264 U.S. 430, 431.

This language also appears:

"Wherever the bankruptcy court had possession, it could, under the Act of 1898, as originally enacted, and can now, determine in a summary proceeding controversies involving substantial adverse claims of title under subdivision e of §67, under subdivision b of §60 and under subdivision c of §70. *But in no case where it lacked possession, could the bankruptcy court, under the law as originally enacted, nor can it now (without consent) adjudicate in a summary proceeding the validity of a substantial adverse claim.*" (Emphasis added) 264 U.S. 433, 434.

The Bankruptcy Act itself, §2a(7), indicates this limitation on summary jurisdiction.

The Trustee's argument, which stresses "the Congressional purpose for efficient, expeditious and inexpensive bankruptcy administration," not only fails to take into account that Congress has not provided for summary jurisdiction over substantial adverse claims when the bankruptcy court lacks possession, but also fails to take into account the test for determining when a claim is substantial so as to require plenary jurisdiction. The test appears in the following language from the case of *Harrison vs. Chamberlin*, 271 U.S. 191 (1926):

"Without entering upon a discussion of various cases in the Circuit Courts of Appeals in which divergent views have been expressed as to the test to be applied in determining whether an adverse claim is substantial or merely colorable, we are of opinion that it is to be deemed of a substantial character when the claimant's contention

> 'discloses a contested matter of right, involving some fair doubt and reasonable room from controversy,' *Board of Education v. Leary, supra,* 527, in matters either of fact or law; and is not to be held merely colorable unless the preliminary inquiry shows that it is so unsubstantial and obviously insufficient, either in fact or law, as to be plainly without color of merit, and a mere pretense . . . .
>
> "In the present case it clearly appears that the validity of the respondent's claim depended upon disputed facts, as to which there was a conflict of evidence, as well as a controversy in matter of law. Its determination involved 'fair doubt and reasonable room for controversy' both as to fact and law. It was therefore substantial, and not merely colorable; and its merits could only be adjudged in a plenary suit." 271 U.S. 194, 195.

The case at bar, clearly being one involving a substantial adverse claim against property not in the Bankrupt's possession, is not the type of case for which Congress has provided that summary jurisdiction exists.

CONCLUSION

The petition for the writ of certiorari should be denied.

Respectfully submitted,

T. Massey Bedsole
3000 First National Bank Bldg.
Mobile, Alabama 36602
Counsel for Respondent

Of Counsel:
Louis E. Braswell
Hand, Arendall, Bedsole,
Greaves & Johnston
3000 First National Bank Bldg.
Mobile, Alabama 36602

CERTIFICATE OF SERVICE

I, T. Massey Bedsole, Counsel for Respondent, hereby certify that three copies of the foregoing brief have been served upon R. Clifford Fulford, Esq., Counsel for Petitioner, by mailing the same, postage prepaid, to him at his office at 433 Frank Nelson Building, Birmingham, Alabama 35203, and that with such service all parties required to be served have been served.